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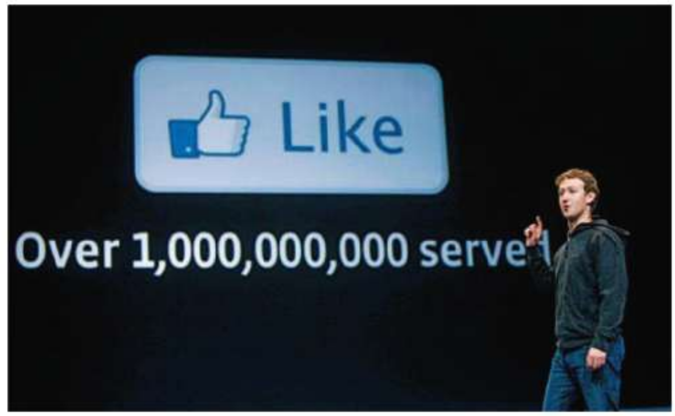
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Corrections & Clarifications

B "As Pessimism Grows, Is It Time to Buy Stocks?" (Markets & Finance, Sept. 20) said "Investors have withdrawn almost $57 billion from mutual funds that invest in U.S. stocks since the beginning of May. ... At the same time, they have put about $597 billion into bond funds." The time period for the bond fund inflows is since the end of 2008, not the beginning of May.

B The 2.5 million unique visitors to Threadless' website, cited in "T-Shirts Are Just the Start for Threadless" (Companies & Industries, Sept. 20), represented traffic for the month of August only, not the whole year.

B In "Jim DeMint's Path to Power" (Politics & Policy, Sept. 20), the senator's statement that he favors "complete gridlock" should have said that businesses have told him they favor compete gridlock.

B "Obama's Blue-Collar Crusader" (Politics & Policy, Sept. 20) incorrectly said that Ron Bloom helped Wilbur Ross save U.S. Steel. The company Bloom helped Ross create out of bankrupt steelmakers did not include U.S. Steel.

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Opening Remarks



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On the Yuan, Be Careful What You Wish For

Trade war fever is rising in Washington. Slapping China with unilateral tariffs would feel good—and make matters worse
By Peter Coy

There's a dangerous fantasy taking hold in Washington: The U.S. can force China to strengthen the yuan. Since the beginning of September the Chinese currency has appreciated about 1.8 percent against the dollar; China may be allowing it to drift higher to stave off American retaliation. Bills pending in the House and Senate would push the Administration to penalize Beijing through tariffs if it doesn't let the yuan rise further. "At a time when the U.S. economy is trying to pick itself up off the ground, China's currency manipulation is like a boot to the throat of our recovery," Senator Charles E. Schumer, a New York Democrat and sponsor of one of the bills, said at a congressional hearing this month.

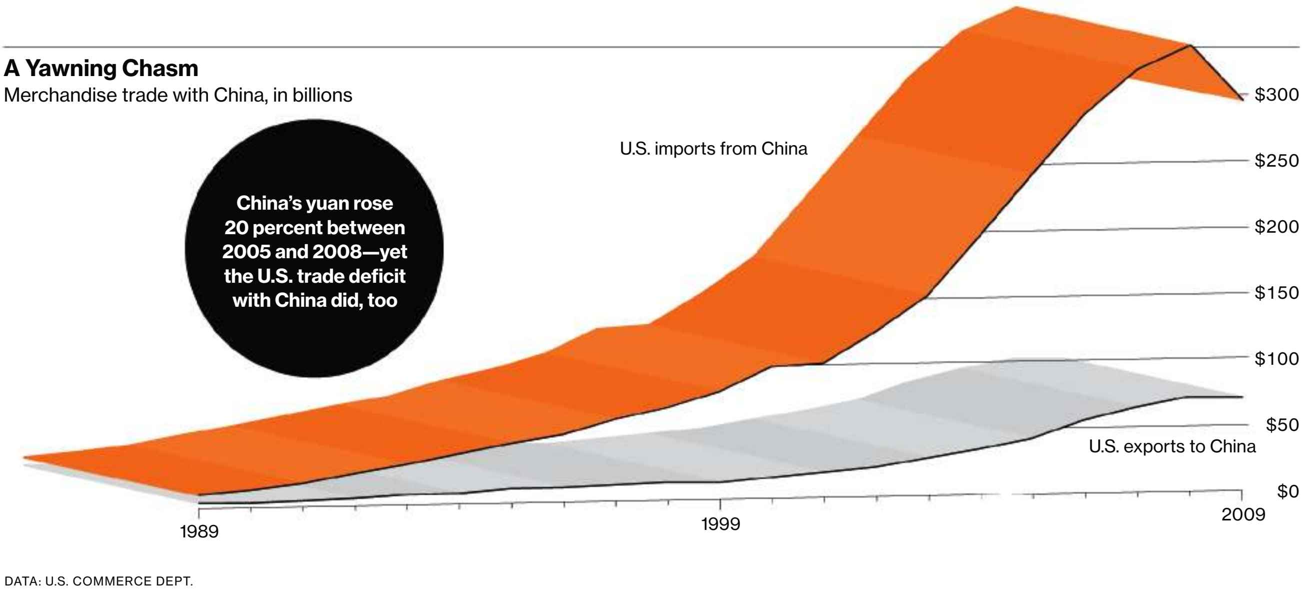
Washington's emphasis on the yuan's value is understandable. It's a conspicuous, trackable indicator of the bilateral relationship. A stronger yuan would shrink the trade imbalance by making American goods more competitive and would help China by suppressing domestic inflation.

Ultimately, though, trying to muscle China into revaluing the yuan would be a mistake. If the U.S. punishes China in ways that aren't allowed by the World Trade Organization, it could risk a trade war, lose the support of other nations, and damage the free-trade system it has worked for decades to develop. By putting so much energy into pushing the yuan upward, the U.S. has less to spend on other critical issues, such as China's discrimination against high-tech imports. And higher inflation in China is already pushing up the yuan's inflation-adjusted value, which is what matters for trade flows. China's global current-account surplus is on track to fall from 10.7 percent of gross domestic product in 2007 to just 2.7 percent in 2011, Deutsche Bank economists estimated on Sept. 22. "The narrow focus on the currency is misguided," says Joanne L. Thornton, an analyst at Concept Capital's Washington Research Group. "You have to look at the broad landscape of issues."

"If they're seen as being slapped," says Cornell's Eswar Prasad, "they would have to retaliate"

China has played it smart. Its authorities have been slow to act

Opening Remarks



on U.S. trade complaints, but they have mostly avoided clear-cut violations of WTO rules. If the U.S. retaliates in a way that's contrary to those rules, it could find itself identified as the bad guy.

One House bill that might run afoul of the WTO was introduced by Representative Tim Ryan, an Ohio Democrat, and Tim Murphy, a Pennsylvania Republican. (It has 150 co-sponsors–proof that everyone sees a political win in bashing China in an election year.) The Ryan-Murphy bill would amend the Tariff Act of 1930 to require the Administration to consider exchange rates when investigating allegations of subsidies or dumping. A currency would be considered undervalued if it was as little as 5 percent below its estimated fair value–a hair trigger that would be hard to defend given there's no precise way to calculate the "correct" value of currencies. Schumer's bill would give the Administration more discretion on whether to prosecute a case, but it's still based on the untested theory that currency undervaluation is a legitimate target for countermeasures. Ira Shapiro, a trade lawyer at Greenberg Traurig who was general counsel to the U.S. Trade Representative under President Bill Clinton, testified before Congress on Sept. 15 that he was "very doubtful" the WTO would allow such an approach. (On Sept. 22 the bill was tweaked in ways its sponsors say will better pass muster at the WTO.)

Hard-liners on China aren't troubled by what the WTO might think. They say the Chinese have more to lose from a trade war, so if push comes to shove, the Chinese would back down. They note that in 1971, President Nixon unilaterally imposed a 10 percent tariff on U.S. imports to prop up the dollar. "No gunboats appeared in New York Harbor then, and they wouldn't today," says Ian Fletcher, an adjunct fellow of the U.S. Business & Industry Council, which represents small American manufacturers. On Sept. 10, Paul R. Krugman, the Princeton University economist and *New York Times* columnist, repeated his call for a temporary tariff to offset the yuan's undervaluation.

Other economists say the U.S. would suffer greatly in a trade war. China is a growing market for American exports. Eswar S. Prasad, a Cornell University professor of trade policy who was chief of the International Monetary Fund's China division, says tariffs might make Chinese leaders less compliant, not more. Their grasp of power is more tenuous than it appears in the West, Prasad says, and to avoid civil unrest, the leadership must demonstrate that it won't be pushed around: "If they're seen as being slapped, they would have to retaliate." China, he says, could undermine U.S. interests through a kind of underground trade war using hard-to-detect measures that discriminate against American interests.

Nations do not devalue their way to greatness. It's hard to imagine that the U.S. would start manufacturing the toys, TVs, and underwear that it now imports from China. More likely it would just pay more for the same items–or buy them from other low-wage nations such as Mexico, Vietnam, and Indonesia. The last time the yuan rose in value, by 20 percent from 2005 to 2008, the U.S. trade deficit with China actually grew by about the same percentage. World Bank President Robert B. Zoellick, in a Sept. 21 interview with Bloomberg Television, tried to strike a reasonable balance. Zoellick, who served as President George W. Bush's U.S. Trade Representative, said that while it's "important to continue to put pressure" on the Chinese, rebalancing the world economy is also linked to what he delicately called "budget issues"–i.e., federal budget deficits that are financed with savings from China and elsewhere.

Instead of stressing over currency, the U.S. should emphasize improving market access for American companies in China, argues John Frisbie, president of the U.S.-China Business Council. Over the past year, China has stepped up its "indigenous innovation" campaign, which aims to develop the nation's high-tech industries. If it does so through subsidies and discrimination against foreign companies, then it's in clear violation of WTO rules. The United Steelworkers union on Sept. 9 launched a trade complaint against China over subsidies of its clean-energy technology. That's the right approach. Austan Goolsbee, President Barack Obama's new chief economic adviser, told Bloomberg editors at a Sept. 22 lunch that the Obama Administration is determined to "enforce the rules of the road" after a drop in trade actions under the Bush Administration.

Coping with China is never going to be easy, yet lashing out in frustration is a recipe for failure. Beijing plays a disciplined, careful game. So should Washington. Ⓑ *–With Mark Drajem and Margaret Brennan*

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● Edited by Christopher Power

The Reluctant Breadwinners

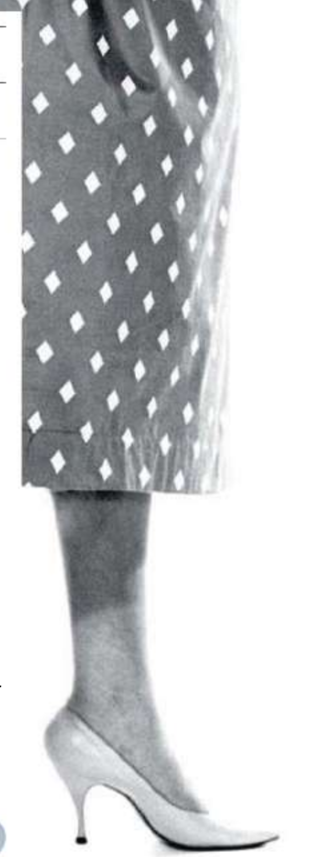


Men accounted for **71%** of the job losses during the Great Recession

American women's median wages are now **83%** of men's

The jobless rate for U.S. women is at **8%**, almost two percentage points lower than for men





▶ As men cope with unemployment, more wives head to work

▶ "The reality is that Joe is not finding a job anytime soon"

Angela Patterson is working as an insurance agent in New York while her husband looks for construction jobs in North Carolina. Diana Gomez had been staying home to care for an ill daughter. When her husband lost his job, she became an administrative assistant in a dentist's office. Michelle, a social worker and mother of three young children in Baltimore, who asked that her last name not be used, switched from part-time to full-time work when her husband was laid off last year. She kept to that schedule after he found work earlier this year—at two-thirds his former salary.

They are the reluctant breadwinners: Women who wanted to stay home until their income suddenly became critical to the well-being of their families. In some cases they are increasing their hours to keep the bills paid. Others are taking up employment for the first time as their husbands struggle to find work. With the anemic recovery keeping the job outlook uncertain, the accelerated gender shift is likely to stick, creating new challenges for U.S. families.

In a study published this September in the journal *Family Relations*, researchers Marybeth J. Mattingly and Kristin E. Smith of the University of New Hampshire found that wives were more likely to enter the job market or increase their hours when their husbands were out of work between May 2007 and May 2008 than when their husbands were out of work amid prosperity four years earlier. These women were also three times more likely to enter the labor force than women whose husbands were working and 51 percent more likely to increase their hours. Smith says difficult times may push women to take jobs they wouldn't consider when the economy is strong. "They have to work," she says. "As families lose their primary breadwinner, they're making ends meet with a lower-earning spouse."

By now, the impact of the recession on the American male is well chronicled: Men accounted for more than 71 percent of the job losses

TRINITY MIRROR/MIRRORPIX/ALAMY; BRIEFCASE: LAWRENCE MANNING/CORBIS

as sectors like manufacturing and construction were crushed. Even when job losses spread to traditionally female-friendly areas like retail and education, women continued to fare better. The latest unemployment figures stand at 9.8 percent for men 20 or over and 8 percent for their female counterparts, with women making up 47 percent of the total labor force.

The recession has accelerated a trend that first became apparent years ago—wives entering the workforce to boost family earnings. The difference now is that what might have been viewed as optional income has become critical. As **Manpower** Chief Executive Officer Jeffrey A. Joerres points out, "the reality is that Joe is not finding a job anytime soon."

That disadvantage notwithstanding, men continue to be paid more. The Bureau of Labor Statistics reports women's median weekly earnings were 83 percent of men's in the second quarter of 2010, up from 76 percent a decade ago. While that's the narrowest gap on record, it's hardly cause for celebration at a time when women earn 60 percent of all bachelor's and master's degrees. The gap also reflects the reality that many of the sectors that attract women tend to pay less than the sectors traditionally dominated by men. Mary Kay Henry, president of the 2.2 million-member Service Employees International Union, argues that "service work is not yet valued in a way that can allow people to support a family." For SEIU, of course, that's an argument for more unionized workers.

The effect of this gender shift in the job market isn't simply economic. Ellen Galinsky, president of the Families and Work Institute, has produced studies that show men now struggle to balance family and career more than women do—45 percent of men report such problems, vs. 39 percent of women. "Work isn't working very well for men," says Galinsky.

Angela Patterson, 44, knows the struggles all too well. When the single mother of two adult daughters met her husband three years ago, she was hoping to find economic security. Instead, he lost his job as a contractor, and Patterson ended up moving from North Carolina to New York to enroll at the Grace Institute, a nonprofit that prepares women for the workforce. The training helped her become an agent for New York Life. She's living with her daughter in New York since her husband doesn't want to come North. "Women are born and bred to be adaptable," she says. "When you have kids and bills to pay, you make sacrifices."

Few experts expect the women who were pushed by recession into the labor market to leave as the economy picks up. Eroded housing values, diminished retirement accounts, and the prospect of higher taxes and anemic wage growth for themselves and their husbands provide these reluctant workers powerful incentives to stay at their jobs.

Diana Gomez, for one, isn't giving up her job in the dentist's office, even though her husband was recalled to his job in a sheet metal factory four months ago. The double income they have now is enough to restore a minimal sense of security. "We can function as a whole family now," says Gomez, who has two children. "We're able to pay the bills. The pressure's not all on me."

—Diane Brady

The bottom line *With lackluster job growth and diminished family savings, the increase in female breadwinners isn't likely to reverse.*

1.85

TRILLION

Value of cash, money-market securities, and other liquid assets held by publicly traded, nonfinancial companies in the U.S. as of June 30. This sum equals 14.7 percent of U.S. market capitalization.

DATA: U.S. FEDERAL RESERVE, BLOOMBERG



Environment

China Confronts A Scary Cleanup Tab

▶ It would cost at least 2 percent of GDP to clean air, water, and more

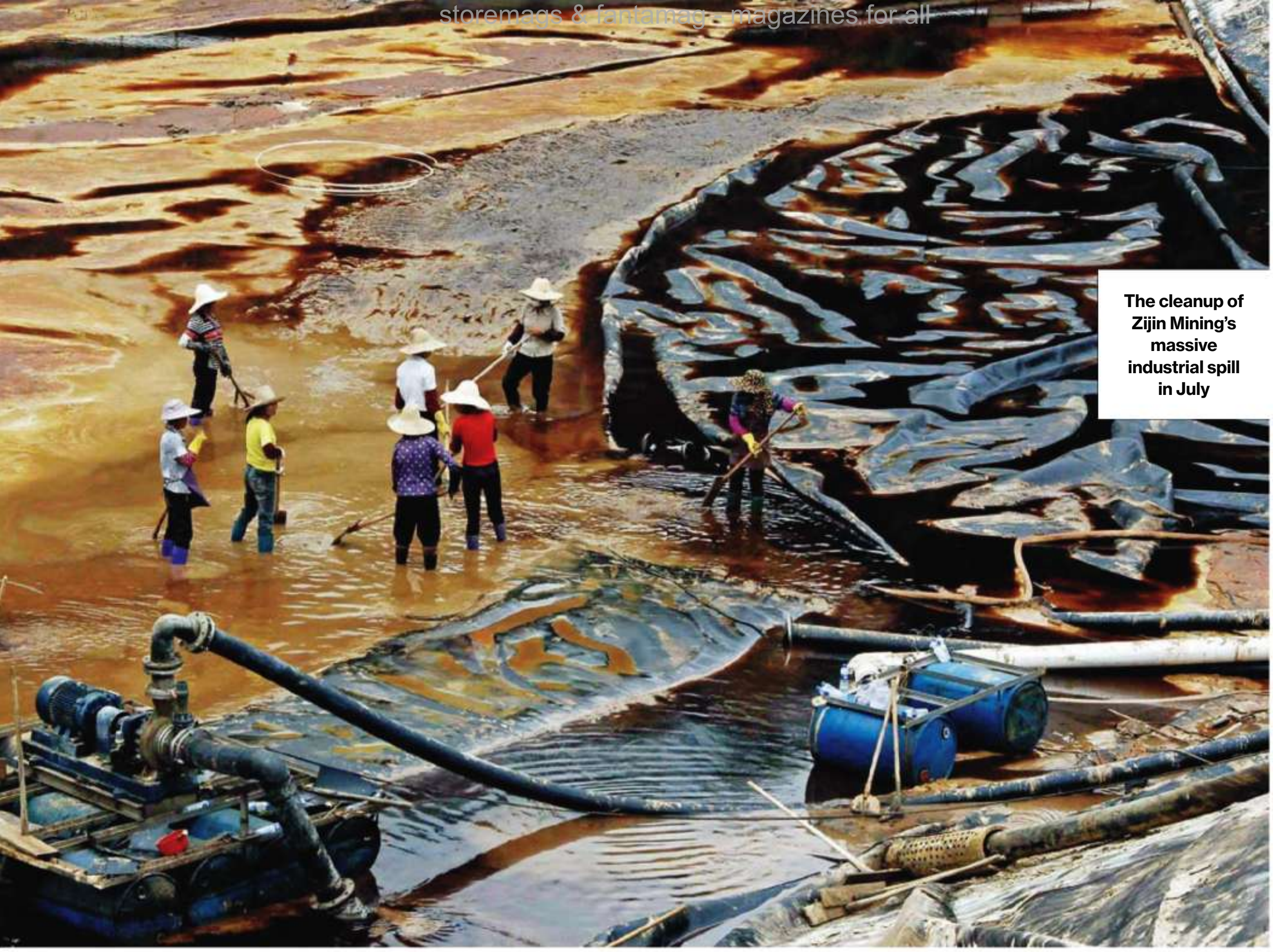
▶ 'If China doesn't address the issues, it might become destabilizing"

Li Pingri remembers the fish and shrimp he saw as a boy in the Chigang creek in Guangzhou. Today, even after the city has spent 48.6 billion yuan ($7.2 billion) on a cleanup of the city's rivers and streams, he can't stand the Chigang's smell. "We are surrounded by black waterways, breathing the foul air every day," says Li, 79, a former researcher at the Guangzhou Institute of Geography. "If we can't breathe clean air or drink clean water, high economic growth is meaningless."

China is pursuing an ambitious plan to build the world's best network of green energy sources and codify the toughest rules on auto emissions. Yet it also should be spending at least 2 percent of gross domestic product annually—or

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The cleanup of Zijin Mining's massive industrial spill in July

680 billion yuan—to clean up the industrial waste it has built up over the last three decades, says Ping He, chairman of the Washington-based International Fund for China's Environment.

Right now, China is spending 280 billion yuan a year cleaning up rivers and other toxic sites, according to the Chinese Academy for Environmental Planning. Although that sum may double between 2011 and 2015, it is far smaller than the 4 trillion yuan China spent on economic stimulus in just one year. At stake are billions of yuan in pollution-related losses and expenses. The costs, including diminished productivity due to health issues, crop degradation, and losses from pollution-related accidents, totaled 512 billion yuan in 2004, the latest figure available, according to the Chinese Academy for Environmental Planning, a branch of the government.

Chinese policymakers face a dilemma. If they vigorously pursue a strategy of undoing the effects of previous contamination and enforcing stricter laws against new emissions, they will raise the operating costs for big employers in such dirty yet vital industries as metals smelting; the smaller players will go under. If the government does not ramp up its efforts, it risks considerable damage to the entire economy. In July Fujian-based Zijin Mining Group, China's largest gold producer, had to shut a copper plant and limit production at a gold mine in eastern China's Fujian province after acid-laced waste spilled into a local river, killing enough fish to feed 72,000 people for a year.

China's biggest gold producer accidentally killed enough fish to feed 72,000 people for a year

Ordinary Chinese, like Li Pingri, are getting fed up. "If China doesn't address the environmental issues when the economy is growing fast, it might become a destabilizing factor in society," says Ma Jun, founder of the Institute of Public Environmental Affairs in Beijing.

Hundreds of villagers in Fengxiang county, Shaanxi Province, tore down the fence around Dongling Lead and Zinc Smelting in August last year and vandalized equipment after government officials blamed the plant for giving more than 600 children lead poisoning, state news agency Xinhua reported. "Environmental protests have been one of the leading sources of social unrest," says Elizabeth Economy, director for Asia Studies at the New York-based Council on Foreign Relations and author of *The River Runs Black*, a book on China's environmental woes. Protesters now communicate with one another via blogs and Twitter accounts devoted to green issues. Up to 10,000 people in Xiamen, Zhangzhou, and Chengdu have fought the planned siting of large-scale chemical plants, and in some cases forced the government to reverse a decision, Economy told the U.S. Congressional-Executive Commission on China in October 2009.

In August, Vice-Chairwoman Chen Zhili of the National People's Congress said the government had done a poor job of using incentives and special funding to persuade factory owners to adopt cleaner production methods. She called for preferential tax rates for companies using cleaner production methods, according to a report from Xinhua.

Chinese Premier Wen Jiabao said at the World Economic Forum's meeting in Tianjin in September

AFP/GETTY IMAGES

Global Economics

that China will cooperate on global efforts to reduce carbon emissions and maintain its efforts on environmental protection. Earlier efforts, such as Beijing's push to clean the capital city's air for the 2008 Olympic Games, haven't been sustained, says Jing Cao, who teaches environmental and resource economics at Tsinghua University's School of Economics and Management in Beijing. Removing polluting factories and limiting the number of vehicles on Beijing's roads "had a visible improvement on the overall environment," he says. "Two years on, however, we see the pollution gradually coming back as car ownership grows exponentially."

At the end of 2008, when Guangzhou pledged to spend billions on a cleanup before the city hosts the 2010 Asian Games in November, the mayor promised that all district head officials would be able to swim in the Pearl River, into which the Chigang flows, after a year. In June 2010, Li Pingri wrote to the mayor pointing out that the water of the Chigang, which runs in front of his apartment, was as bad as ever. Says Li: "It's too ambitious to think that all the pollution accumulated over the decades can be cleaned up in a year and a half."
—*Glenys Sim and Feiwen Rong*

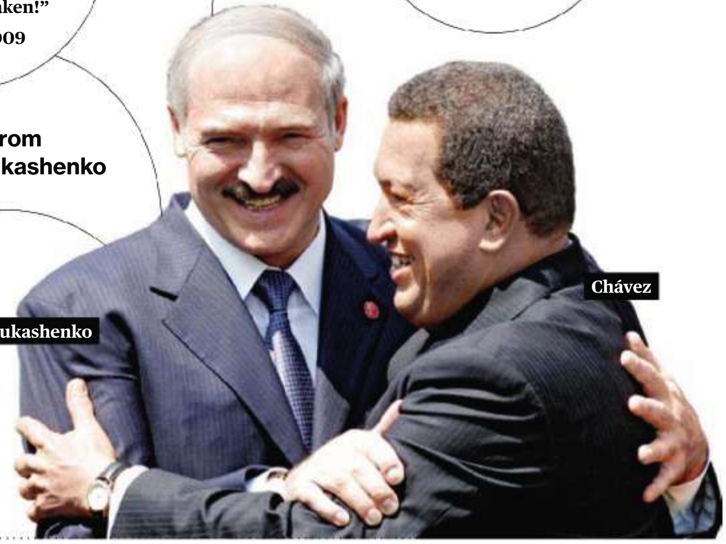
The bottom line *Analysts say that China needs to spend hundreds of billions more on cleaning up polluted sites around the country.*

Quotations from Chairman Lukashenko

"If someone in the West thinks that our relations with Russia have soured and now we can bring Lukashenko around and he'll let all the prisoners out of jail, they are much mistaken!"
—Aug. 20, 2009

"Despite the fact that Russia keeps scratching various parts of our body, we are not dead set against it. We adequately assess what's going on."
—Sept. 14, 2010

"During the last election, 93 percent of the people voted for me. I admitted that I had falsified the results. I gave an order so we wouldn't have 93 percent but somewhere in the region of 80 percent."
—Aug. 27, 2009



Energy

Belarus' Quixotic Leader Defies Russia

▶ The ex-Soviet republic uses pipeline, potash, Chávez as leverage

▶ "Lukashenko ... wants to show that he has some alternatives"

In August, a Greek-flagged tanker docked at the Lithuanian port of Klaipeda, after a 5,500 mile journey from Venezuela. The ship unloaded 80,000 tons of Venezuelan crude, which was then moved by rail to the giant Mozyr oil refinery in the landlocked nation of Belarus. More deliveries to Belarus—the first shipment arrived via Odessa in May—are scheduled for this year and next.

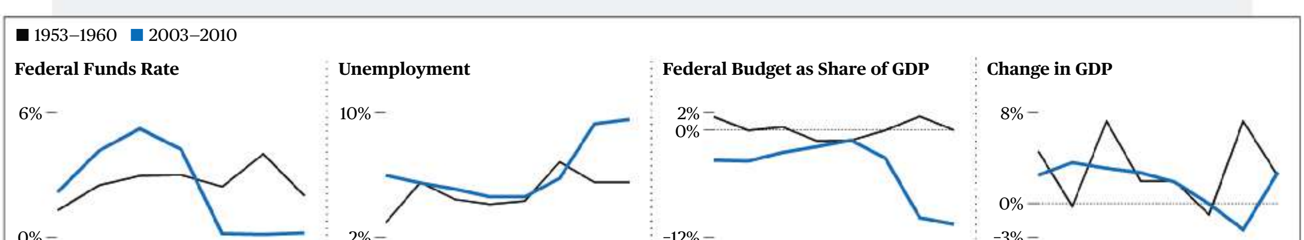
Venezuelan oil in Eastern Europe? The traditional oil source for Belarus, an ex-Soviet republic, has been Russia, its neighbor and longtime patron. A decade ago relations between Belarus President Alexander Lukashenko and the Kremlin were so close that he agreed to a union with Russia. When Vladimir Putin became Russian president, though, the Russians put the union plan on hold and in 2007 proposed a common trade bloc with Belarus and Kazakhstan.

Lukashenko has dragged his feet on joining, and though he has agreed to the deal, he has exasperated the Kremlin by revisiting the terms of Russia's oil and

Interest Rates

Same Low Yields, Different Economies

Money managers at bond giant PIMCO say we're entering an era when Treasury yields will reach the low levels that prevailed during the Eisenhower Administration. If so, we'll have low yields for very different reasons than in the 1950s, when budget surpluses were common, unemployment never exceeded 7.5 percent, and growth was far more robust.



DATA: FEDERAL RESERVE BANK OF ST. LOUIS, BUREAU OF ECONOMIC ANALYSIS, BUREAU OF LABOR STATISTICS

QUOTES: IZVESTIA, INTERFAX, BELTA

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Salmon showdown at the FDA page 20 ▶



gas sales to Belarus. The Belarus leader has lambasted Putin in public. Belarus state TV even aired an interview with the President of Georgia, with which Russia fought a five-day war in 2008.

Stung by what it sees as a lack of support, the Kremlin has threatened to stop subsidizing its oil and gas sales to Belarus. For years Belarus got Russian oil at a 36 percent discount to Russia's export duties, a gap Belarus exploited by selling much of the oil at higher rates to Western Europe. Belarus can ill afford to lose the subsidy—worth $4.2 billion this year, according to Putin—and has sued Russia in the CIS Economic Court, which presides over cases involving the old Soviet republics. The subsidy is equal to 7.6 percent of Belarus' gross domestic product.

In his struggle with Russia, Lukashenko has explored an alliance with the European Union. The EU, however, regularly blasts Belarus for human rights violations and wants democratic reform in Belarus to precede any financial support. So Belarus has started looking further afield. "Lukashenko is afraid to be left one-on-one with Russia. He wants to show that he has some alternatives," says Arkady Moshes, program director for research on Russia at the Finnish Institute of International Affairs in Helsinki.

Which leads back to Venezuela. In March, Lukashenko cut a deal with Venezuelan President Hugo Chávez. Oil from Venezuela would, according to Belarus, replace Russian supplies and allow the new partners to sell oil products to Europe. Analysts say the arrangement is not commercially viable at the moment, suggesting at least one side is acting out of political rather than economic interests. Chávez may be using his new ties with Belarus to show his global influence, according to Chris Weafer, chief strategist with UralSib Capital. "It's all part of the geopolitical game," he says.

Lukashenko has other cards to play. A quarter of Russia's oil exports flow through Belarus via a pipeline to the rest of Europe. Russia needs that pipeline, so it cannot provoke Belarus so much that Lukashenko shuts it down. The biggest chip Belarus possesses, however, is potash, a key ingredient in fertilizer. Belarus' mines have 1 billion tons of the stuff, the third-largest reserves after Canada and Russia.

In January Chinese Vice-President Xi Jinping visited Belarus and pledged $10 billion in Chinese investments in addition to a $5.7 billion credit line. The Chinese also bid for a stake in Belaruskali, the state potash producer. Developing a potash business with the Chinese would weaken Russia's grip on Belarus. Lukashenko has to be careful, though: Selling too big a stake would give the Chinese leverage to demand lower prices.

The Russians have retaliated. Two state-run Russian television channels that can be viewed in Belarus ran documentaries on Lukashenko's treatment of the opposition. Putin has tried the carrot as well as the stick. As Europe voiced fears earlier this year that the oil pipeline would be turned off, he offered, for one more year, to sell Belarus the 6.3 million metric tons of oil it needs for domestic use under the usual favorable terms.

The Venezuelan crude keeps coming. Shipments will be 4 million metric tons this year and twice that next year, says an official in Lukashenko's administration, who in line with state policy declined to be named. "Many experts just don't understand the prospects of the Belarus economy," says the official. "They can think what they like. The conflict has been a positive factor, pushing our companies to look for new markets." Analyst Weafer points out that geography may be destiny: "Russia and Belarus are stuck with each other."

—*Yuriy Humber*

***The bottom line** Belarus is seeking new economic ties with the rest of the world, especially Venezuela and China. Its potash mines are a big asset.*

Currencies

The Koreans Don't Want A Super Won

▶ **Strong exports, record earnings keep nudging the currency upward**

▶ **"The most critical factor is whether the won stays at the current level"**

Will Korea follow Japan's lead and weaken its currency? Speculation about Korean won intervention has circulated among currency traders in Seoul since Sept. 15, when Japan sold enough of its own currency to drive the yen down 2.5 percent in one day. "We think the Bank of Japan will intervene in

➜

Tom Keene's EconoChat

Tom talks with **R. Glenn Hubbard,** dean of Columbia Business School, about repairing the economy.

Why does the path to economic ruin run though Washington?
Our problems in the U.S. are not going to be fixed by quick fixes. And the policies that both parties have pursued toward the short term have made our problems worse.

What do we need to do to jump-start manufacturing in the U.S.?
We need to stop tying our hands behind our backs. We need to change tax policy that penalizes manufacturing. We need to promote research and development and innovation. We also have a very litigious society that discourages manufacturing.

What does the President need to do about tax policy?
It's really pretty simple. It's saying, "Let's extend the Bush tax cuts until we have the next Presidential election so that we can have a real debate on the size of government and how we're going to pay for it." That would clear up an awful lot of uncertainty.

Defend the plutocrats' arguments against the President.
About half of the people in the top 1 percent of income are business owners, so they're the people who create jobs. It is not us vs. them.

Is stimulus working?
We had a package that the Congressional Budget Office costs out at $814 billion. That's equivalent to giving almost $100,000 to every newly unemployed person. We know it didn't have a very significant effect. Ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

FROM LEFT: LUIS ACOSTA/AFP/GETTY IMAGES; PAUL DARROW/THE NEW YORK TIMES/REDUX; ANDREW HARRER/BLOOMBERG

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Global Economics

the yen until it hits 88 per dollar," says Yun Se Min, a Seoul-based currency trader at **Busan Bank**. "This will provoke the Korean central bank to intervene." The yen is trading around 84 to the dollar: The cheaper it gets, the more affordable its exports will be, especially in the U.S.

It's a little hard to figure out why the Koreans expect an intervention by the Bank of Korea. True, at almost 1160 to the greenback today, the won is 27 percent stronger than at its weakest point in March of last year, when the global economy was in terrible shape. Compared to its strongest point in the fall of 2007, though, the won is still almost 30 percent weaker. Though the median estimate of currency strategists is for the won to strengthen another 9 percent through 2011, that would still leave it weaker than three years ago.

Meanwhile, Korea is thriving. Aided in part by a weak won, Korea's exports will probably increase 26 percent this year, according to the government. Investors have pushed the benchmark Kospi Index up 9 percent this year: Japan's Nikkei has dropped 9 percent.

Yet the Koreans are starting to worry. All those repatriated profits and portfolio fund dollars have pushed the won up over 3 percent in September, making it Asia's best performer. "The most critical factor is whether the won remains at the current level," says Cho Hwan Eik, president of the Seoul-based Korea Trade-Investment Promotion Agency. He adds that export growth may start to slow in the fourth quarter if the won gets much stronger. "We're not in a safe zone," he says. Lee Seung Woo, a consumer electronics analyst at Shingyoung Securities in Seoul, says that with demand for personal computers and televisions weak, a stronger won would be a further burden for Korean tech companies.

The won faces "the strongest appreciation pressures" in the region, according to a Sept. 13 report by **Goldman Sachs**. If the won does keep strengthening–and if a weaker yen makes archrival Japan more competitive–pressure will mount on Seoul to act.
—*James Regan, Eunkyung Seo, and Frances Yoon*

The bottom line *The Korean won has remained surprisingly weak for two years, giving Korean exporters an edge. Now it is strengthening.*

ILLUSTRATIONS BY HENNIE HAWORTH

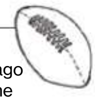
Seven Days

by Ira Boudway

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IPO for biofuel maker Amyris on Nasdaq

The Green Bay Packers and Chicago Bears meet—for the 180th time—on *Monday Night Football*



- **Shop.org Annual Summit:** The online wing of the National Retail Federation hosts over 100 companies in Dallas.
- **Paychex earnings:** The payroll firm makes its first report since Jonathan Judge resigned as CEO in July.

28

The U.K.'s second-quarter GDP announcement

U.S. Consumer Confidence Survey



- **Barnes & Noble general meeting:** The proxy battle between Ron Burkle and the bookseller's board comes to a head in a vote on Burkle's proposal to replace three board members and revise the company's poison-pill plan.



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Euro zone consumer confidence

Family Dollar earnings report



- **IPO for Liberty Mutual Agency:** The Boston insurance company is seeking to raise as much as $1.4 billion in a 64 million-share sale that would be the largest this year.



30

Gauguin opening at Tate Modern in London

Japan's housing starts, unemployment, and vehicle production

- **Mexico's Leading Economic Index:** The Conference Board releases numbers for July. The Mexican index declined sharply in May on a weakened peso and was nearly flat in June.

01

WTO reviews U.S. trade policy



- **National Day of the People's Republic of China:** Begins a week-long holiday celebrating 61 years of communist rule.
- **Ryder Cup:** European and U.S. teams compete in match play golf in Wales.



02

Gandhi Jayanti: National holiday in India celebrating birth of Gandhi

- **California Gubernatorial Debate:** Fomer eBay CEO Meg Whitman and State Attorney General Jerry Brown square off in Fresno in the third of four scheduled debates.

03

German Unity Day commemorates reunification in 1990

Final day of Major League Baseball's regular season

- **Arsenal vs. Chelsea:** Two of London's top-table Barclays Premier League soccer teams meet at Stamford Bridge.

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**SmartMoney* magazine, June 2010. Industry review ranking 17 leading discount brokers. Results based on ratings in the following categories: commissions and fees, interest rates on cash, mutual funds and investment products, banking services, trading tools, research, and customer service. Criteria not equally rated.

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‡Commission comparison based upon published Web site commissions as of 8/31/2010 for Schwab, TD Ameritrade, and Vanguard for online non-proprietary ETF trades. Vanguard pricing based on $50K–$500K in assets invested in Vanguard funds or ETFs. Other pricing may be available based on a specific asset level or a combination of trading and asset levels.

§Comparison based on trading in 25 iShares ETFs, and excludes each broker's proprietary ETF offerings. Schwab and Vanguard offer 11 and 55 proprietary ETFs commission free, respectively, as of 9/10/2010. TD Ameritrade has none.

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Contents ▶ A food fight over genetically altered salmon 21 ▶ Big Pharma wants to use stem cells to screen drugs 22 ▶ Speed Dial: Warren Bennis 22 ▶ Rubber prices come bouncing back 24 ▶ Briefs 25 ● Edited by James E. Ellis



TNK-BP's Samotlor oil field in Siberia

How BP Learned to Dance With the Russian Bear

▶ Its Russian joint venture, TNK-BP, is a source of cash and growth for the beleaguered oil giant

▶ As BP sheds assets, there's "no need to sell to a competitor and make them stronger"

In July 2008, Robert W. Dudley, then chief executive officer of **TNK-BP**, a joint venture between Britain's **BP** and a group of Russian billionaires, hastily left Russia after complaining of "sustained harassment" from his local partners. Dudley had been driven to flee the country by a barrage of lawsuits, tax probes, difficulties obtaining work permits, and other legal pressures that became a hallmark of the acrimonious partnership's battles over management control and investment direction. One Russian court even barred Dudley from performing his job for two years for allegedly violating local labor laws.

How times have changed. On July 27, the very day Dudley was tapped to replace Tony Hayward as BP's chief executive, he got a congratulatory phone call from Mikhail Fridman, the Russian oligarch who is TNK-BP's executive chairman and interim CEO. Fridman jokingly offered to help Dudley get a Russian visa. Soon after, Dudley and Hayward, who will join TNK-BP's board, flew to Moscow to meet with Fridman, one of Russia's richest men. "The attitude of BP toward TNK-BP has changed," Fridman said in an interview at his Moscow office. "We had an intense dispute. We think TNK-BP should not be a BP branch."

Now, with three independent directors added to the board, including former German Chancellor Gerhard Schröder, and the appointment of a 36-year-old Russian, Maxim Barskiy, as CEO, that's no longer an issue. Explains David Peattie, head of BP Russia: "There is a different attitude on the part of both sets of shareholders. Now TNK-BP… is able to be more independent."

The rapprochement couldn't come at a better time for BP. TNK-BP, which used to look like a huge headache, now seems like a godsend, providing cash-pinched BP billions in dividends annually, huge reserves of cheap-to-raise oil, and a safe haven from the blistering criticism it's received in the U.S. over the handling of its huge spill in the Gulf of Mexico. Russians are "more philosophical" about such mishaps, says Fridman, adding that BP helped improve safety at the Russian unit. "We know this business generates situations like that."

ALEXEI KOZAK/LANDOV

Companies&Industries

TNK-BP is a major oil company in its own right, producing about 1.9 million barrels per day of oil. That's about half what BP produces and triple the output of large U.S. independent **Anadarko Petroleum**. BP's share of TNK-BP's production accounts for about one quarter of its own output and a fifth of its reserves. For the first half of 2010, production at the joint venture rose a strong 4.5% from the same period in 2009. TNK-BP pays close to $2 billion in yearly dividends to each of its ownership groups—cash BP needs.

Both sides now seem to recognize their co-dependence: The Russians need BP's expertise while the Brits need access to Siberia's cheap crude. So BP has backed off, allowing Fridman and his partners to largely run the company their way. The biggest change is a willingness to allow TNK-BP to expand widely abroad. BP was long skeptical of TNK-BP operating beyond the former Soviet Union, which would take the venture into areas where BP has extensive operations of its own. Now the two sides are discussing TNK-BP buying BP assets in Venezuela, Vietnam, and Algeria.

As a Russian company, TNK-BP may be better positioned to work with contentious governments such as that of Hugo Chávez in Venezuela. "I don't doubt that a Russian company has more leverage with Venezuela than BP, so from that point of view this makes sense," says Artem Konchin, an analyst at Unicredit Securities in Moscow.

Moreover, BP executives figure such sales could be a painless way to raise cash to help pay the expected tens of billions in costs related to the Gulf spill. BP plans to raise $30 billion through asset sales over the next 18 months. Selling to TNK-BP would not only raise cash but, as 50% owner of the venture, the London-based company also would retain influence over management and development of the assets. This "means there is no need to sell to a competitor and make them stronger," Fridman says.

That portends big change at TNK-BP. Fridman says he would eventually like to see the joint venture's dependence on Russia cut in half from its current 100 percent. Right now, the company's biggest opportunities lie inside Russia, the world's largest oil producer. TNK-BP's



challenge is to maintain production levels at its mainstay Soviet-era oil fields in West Siberia and the Urals while bringing on promising new fields in areas such as Siberia's Yamal peninsula.

The heart of TNK-BP is Samotlor, a sprawling 700-square-kilometer oil deposit lying beneath sandy swampland near Nizhnevartovsk in West Siberia. Samotlor was discovered about 40 years ago and once held about 55 billion barrels of oil. The field now requires that tremendous quantities of water be pumped into its reservoirs to maintain adequate pressure for oil extraction. Although the liquid produced by the wells is 95% water, Samotlor still churns out about 560,000 barrels per day—one-quarter of TNK-BP's total production.

The company's oil fields are money-spinners because of their rock-bottom operating costs. Samotlor wells cost only $1 million to $2 million to drill, for a mere $2.20 a barrel finding cost. A new field called Ust Vakh was recently developed by the joint venture near Samotlor at a cost of about $1 billion; it paid for itself in only 18 months, according to Vitalyi Federov, TNK-BP's head of long-term planning. And Chief Operating Officer Bill Schrader, a BP veteran, says the Yamal could produce up to 900,000 barrels a day in 10 years if adequate pipelines can be built. Given those prospects, Dudley has every reason to dance with the bear. —*Stanley Reed*

The bottom line *As its prospects in the Gulf of Mexico dim, embattled BP can turn to its TNK-BP joint venture for cash and growth.*

PAUL DARROW/THE NEW YORK TIMES/REDUX

Law Firms

Where Corporations Turn for Legal Help

Research and advisory firm Acritas publishes rankings based on its global survey of 1,000 executives about law firms they employ most often for cross-border litigation and deals. Acritas' "brand index" factors in awareness and attitudes toward firms.

Rank	Firm	Brand Index
1	Baker & McKenzie	100.0
2	Clifford Chance	86.9
3	Freshfields Bruckhaus Deringer	67.3
4	Linklaters	66.5
5	Allen & Overy	56.3
6	Jones Day	52.3
7	DLA Piper	39.7
8	Hogan Lovells	37.8
9	Skadden	37.7
10	White & Case	26.3

Baker & McKenzie: Won a U.K. appeal on behalf of Lehman Bros.' unsecured creditors in August

Freshfields Bruckhaus Deringer: Retained by BP to bolster its post-spill takeover defenses

Hogan Lovells: Supreme Court Chief Justice John Roberts and Justice Dept. antitrust chief Christine Varney worked here

White & Case: Represented Log Cabin Republicans in their lawsuit to overturn "Don't Ask, Don't Tell" policy

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Because it incorporates DNA from a different variety of fish, AquaBounty's salmon reaches "market weight" in half the normal time

Aquaculture

This Genetically Altered Salmon Is No Fish Story

▶ Inching toward FDA approval, AquaBounty's mega-fish stir critics

▶ "Call this genetically engineered fish what it is: Frankenfish"

For 15 years, **AquaBounty Technologies** has tried to win U.S. approval to sell a genetically modified salmon that can reach full size up to twice as fast as its naturally occurring brethren. Now the effort by the Waltham (Mass.) company may be drawing to a close. U.S. Food and Drug Administration advisers last week held what may be the agency's final hearing on whether AquaBounty's salmon is safe to eat.

The FDA hasn't set the timing of a final decision. Its staff, though, has already agreed that the meat from the altered fish is safe and has no biologically relevant differences from that of the naturally occurring variety. So AquaBounty's fish finally may be headed for American kitchens. FDA approval could make the salmon the first in a series of animals with mix-and-match DNA that have the potential to change the U.S. food chain.

AquaBounty's Atlantic salmon contain a growth gene implanted from another variety of salmon that's activated by DNA from an eel-like creature called the ocean pout. The altered fish can grow to "market weight" of as much as 13 pounds in two or three years, compared with three to four years required for natural salmon, says Chief Executive Officer Ronald L. Stotish.

The company would sell its AquAdvantage brand salmon eggs to fish farms isolated from the ocean that then could see their catch reach supermarkets in about two years. Stotish says the enhanced fish could "increase the availability of a high-quality product that is indistinguishable from the traditional food."

Not everyone is firing up their grills just yet. Groups opposed to genetically modified foods on Sept. 16 held a protest in Washington. "Today it's a fish that we're talking about. But very soon it will be genetically engineered pigs, chicken, and our beloved cows," Ben & Jerry's CEO Jostein Solheim told protesters.

Critics say they're particularly miffed that the FDA is reviewing AquaBounty's altered fish as a veterinary drug rather than creating a new review process for gene-altered foods. FDA spokeswoman Siobhan DeLancey says the genetic material used in the AquaBounty fish meets the statutory definition of a veterinary drug because it alters the structure and function of the animal. She says veterinary drug approval is stringent: "The review of the AquAdvantage salmon, conducted under that process, includes a rigorous analysis of food safety and application of a stringent safety standard: 'reasonable certainty of no harm.'"

The FDA's decision, critics say, allows some testing data reviewed by regulators to be kept confidential, as trade secrets. "They're obviously using this veterinary designation to keep the data confidential," says Wenonah Hauter, executive director of Food & Water Watch, an environmental and food-safety group in Washington. "I think they're afraid of the public reaction."

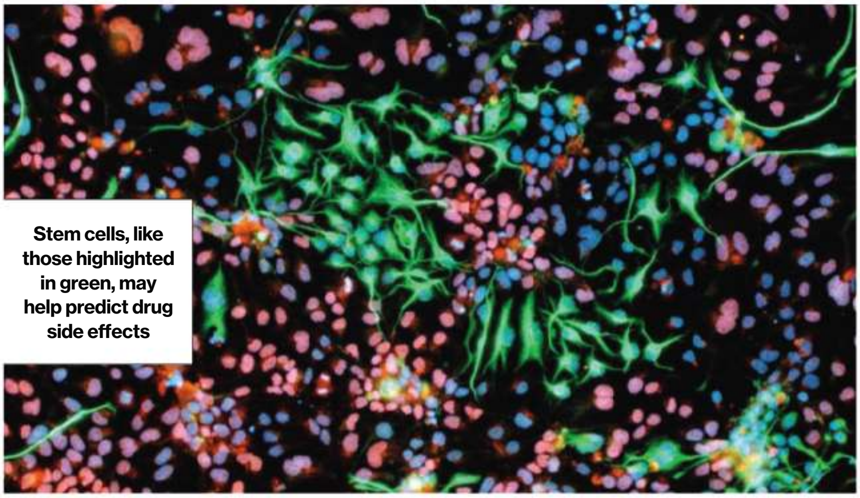
Alaska Senators Mark Begich and Lisa Murkowski, whose state harvested 163 million commercial salmon last year, are also against AquAdvantage. "Let's call this genetically engineered fish for what it is: Frankenfish," Begich said in a statement. "Approval of genetically modified salmon, the first such hybrid to be considered for human consumption, is unprecedented, risky, and a threat to the survival of wild species."

The modified fish, all female, are sterile, so they can't reproduce with regular salmon, Stotish says. "People who take the time to look" at the regulatory data "will satisfy themselves that the FDA has taken a very cautious, very robust regulatory approach," he says.

Stotish says 97 percent of the total tonnage of salmon now consumed in the U.S. is imported. Almost 427,000 tons, valued at $1.39 billion, was imported last year from countries led by Chile, Canada, and Norway, according to Agriculture Dept. data. Although he says it's too early to project the sales potential of AquAdvantage eggs, Stotish says the fast-growing salmon could help domestic fisheries gain a larger share of the market.

The genetically engineered salmon eggs are produced at an AquaBounty facility in Prince Edward Island, Canada, and the fish are grown to market weight at an AquaBounty farm in Panama. If the FDA approves the aquaculture company's salmon, another company would sell the Panama-grown fish in the U.S., Stotish told reporters at a Sept. 20 FDA advisory panel meeting. He declined to identify the company because the product hasn't been approved yet. "AquaBounty does not plan to be in the fish business," he said. "We're a technology company." —*Molly Peterson*

The bottom line *Although genetically modified crops have been used for 20 years, AquaBounty's gene-altered salmon is facing fierce scrutiny and protests.*



Stem cells, like those highlighted in green, may help predict drug side effects

Pharmaceuticals

Stem Cells May Save Big Pharma a Bundle

▶ Researchers use modified cells to predict drug reactions in humans

▶ "This is transformative technology that puts human disease in a dish"

It's a frustrating and expensive pitfall for pharmaceutical companies: discovering late in the game that a promising new drug has side effects in humans that never surfaced in the laboratory or during earlier trials in animals. That kind of setback sends scientists back to the lab—or even prompts a company to shut down a multimillion-dollar drug development program. Researchers at **Roche Holding, Pfizer**, and **GlaxoSmithKline** hope to use human tissue created from stem cells to reduce such mishaps.

For more than a decade, stem cells (master cells that form all other cells in the body) have been hailed as potential treatments for Parkinson's disease, spinal cord injuries, and diabetes. While those advances are years away, Big Pharma has begun using the cells to help identify potentially dangerous side effects from drugs under development before they undergo expensive human trials.

Earlier this year, Roche scientists used heart tissue made from stem cells to test an antiviral drug it had abandoned two years earlier because it caused irregular heartbeats in rodents and rabbits. The same dangerous effects were seen in the lab using the stem cell-generated heart cells. The finding is important to drug researchers because it showed that human tissue grown from stem cells can mimic the body's reaction to medicines, helping spot side effects early. And that matters greatly in an industry that can spend upward of $4 billion to produce a new drug. Had stem-cell-derived heart tissue been available two years ago, Roche could have pulled the plug earlier on its antiviral drug, saving millions, says Kyle Kolaja, Roche's global head of predictive toxicology screens and emerging technologies.

"This is a transformative technology that puts human disease in a dish," says Christopher Scott, director of the Stem Cells in Society program at Stanford University School of Medicine. "It can help companies see the drugs that work and also the ones that are toxic."

The savings can be substantial. A drug study in mice alone can cost about $3 million, says Michael C. Venuti, chief executive officer at **iPierian**, which is developing drugs using stem cells. A drug that's found to cause cardiac damage only after it has advanced to large, late-stage human studies might cost a company $1 billion or more, says Jason Gardner, a Glaxo vice-president who heads its stem cell drug performance unit. "There is a real need to more accurately model human physiology," he says.

The stem cells being employed by drugmakers don't come from embryos, thereby avoiding an ethical and political controversy that's dogged the technology. Instead they were created using a method that allows scientists to

Speed Dial
Warren Bennis

The management guru and founding chairman of the Leadership Institute at the University of Southern California on leading today.

You wrote *On Becoming A Leader* two decades ago. What's changed?
It's a brutal time for anyone in leadership. Never have you had to communicate with so many constituencies. It's hard to even sort out what all the variables are. I don't think I've seen anything like it.

Where do you start?
Your first goal is to help your constituents—whether they're shareholders or customers or otherwise—understand reality. You have to be able to articulate what steps your team is taking to confront this reality, and you've got to be straight about it. Too many people fall prey to the mud factor with cloudy, hard-to-interpret statements.

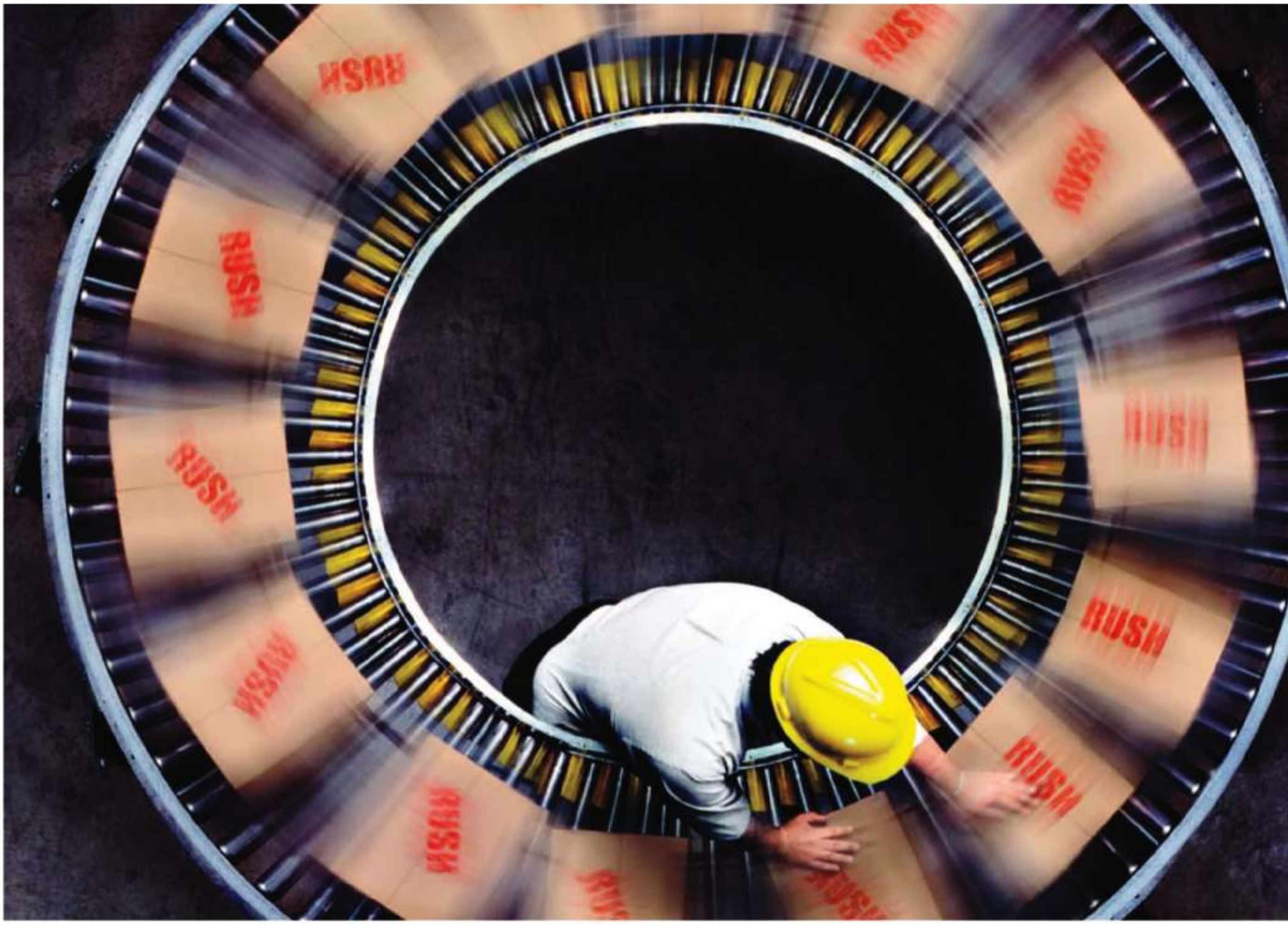
The art of the sound bite!
Sound bites are important. A leader has to talk to people's hearts. Sound bites give specificity, but they have to be relevant and meaningful and resonant. Don't talk about five-year plans. Be specific and help people deal with complexity without getting into the five-year-old mindset.

What advice do you have for anyone who wants to be a CEO?
The first thing I would say is forget about balance of work and family. It's more than a full-time job. Abandon your ego. You can't solve everything yourself, so you've got to learn to build and work with a top team. If you don't have that, forget it. And you have to connect with as diverse a group as possible. You have to be realistic as hell about the sacrifices to become a leader. But if you pull it off, you can make life better for so many people. What could be sweeter? —*Diane Brady*

THE NEW YORK STEM CELL FOUNDATION

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Companies&Industries



Obama's agenda-bender page 27 ▶



Bundling rubber in Thailand, where deluge followed drought

transform ordinary skin cells into another type of stem cell (known as induced pluripotent stem, or IPS, cells) as versatile as embryonic cells.

Cellular Dynamics International, a company founded in 2004 by James Thomson, the University of Wisconsin scientist who first isolated human embryonic stem cells in 1998, made the heart cells used by Roche and also being tested by Glaxo and Pfizer. The company is now producing more than 7 billion heart cells a month made from skin and blood, says Robert Palay, CDI's chief executive.

Next year, the company plans to start selling liver and nerve cells as well. "Others are talking about the promise of stem cells, we are delivering today," Palay says. Cellular Dynamics is backed by $70 million from private equity groups including Sam Zell's **Equity Group Investments** and Palay's **Tactics II Stem Cell Partners**.

Competitor iPierian is making cells from people with heart disorders, diabetes, and neurological ailments to develop drugs that threat these disorders. Founded by venture capitalists at Kleiner Perkins Caufield & Byers in Menlo Park, Calif., the company was built on the work of Shinya Yamanaka of Kyoto University in Japan, who turned skin cells into IPS cells back in 2006. It has since raised $60 million including money most recently from the venture arms of **Google**, Glaxo, and **Biogen Idec**.

IPierian has made IPS cells from the skin of children with spinal muscular atrophy, a deadly muscle-wasting condition. Morphing the stem cells into neurons that carry the disease, they've identified drug candidates that may help motor neurons to survive, said Venuti, iPierian's CEO. The company also used the neurons to test 15 drugs that previously failed in clinical trials, said Corey Goodman, iPierian's chairman. The signs of failure were evident in each case, he said. "IPS technology gives you the opportunity to screen out a lot of things that are going to fail," said Goodman, who formerly was head of Pfizer's biotechnology unit. "That saves money, emotion, and testing." —*Rob Waters*

The bottom line *Drugmakers hope to save big by using stem cells to test drugs for dangerous side effects long before costly human trials are needed.*

Commodities

The Squeeze on Global Rubber Supplies

▶ Freakish weather hurts rubber production across Asia

▶ A Japanese condom maker gets "a headache"

Extreme weather across the globe this year, from drought conditions in Russia and Ukraine to flooding in Pakistan and Canada, is lighting a fire under commodity prices. Wheat prices have spiked since June, while corn rallied to a 23-month high, coffee reached a 13-year peak, and cotton advanced to its most expensive levels since 1995. Now the price of rubber, a key industrial commodity, is taking off.

Goodyear Tire & Rubber and **Cooper Tire & Rubber**, the two largest U.S. tiremakers, have begun notifying customers they will raise tire prices by as much as 6.5% by early November. **Bridgestone**, the largest tiremaker by

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sales, said in late August that it's increasing prices by up to 6% in Europe, the Japanese company's second price increase this year.

The industry is facing supply problems owing to bad weather that hit rubber production in Asia. "Drought earlier this year and heavy rains later on hampered tree-tapping across Asian plantations," says Pongsak Kerdvongbundit, managing director of **Von Bundit**, a big natural-rubber producer and exporter based in Phuket, Thailand. "Global production will lag behind soaring demand for at least another two years."

Inventory stockpiles of rubber, also used in products like gloves and condoms, will drop 12 percent and cover just 67 days of projected demand in 2011, the lowest level in at least a decade, according to Goldman Sachs analysts in a Sept. 3 report. Consumption will outpace supply by 127,000 metric tons, the most since 2007, the bank estimates. Prices of rubber futures in Singapore may jump 20 percent by March, says Makoto Sugitani, a senior director at Newedge Japan. If so, that would work out to a record $4.20 a kilogram.

The global economic recovery and white-hot growth in China are powering demand for rubber products. World auto sales, propelled by Chinese demand, will increase 8 percent this year, to 68.5 million cars, and 7.2 percent, to 73.4 million cars, next year, figures Ashvin Chotai, London-based managing director at Intelligence Automotive Asia.

Tiremakers are passing on the higher costs, and future hikes can't be ruled out. "We don't do a lot of raw-material hedging" says Keith Price, a spokesman for Akron-based Goodyear.

Top Glove, based in Selangor, Malaysia, the world's biggest rubber-glove maker, passes on "the majority" of higher costs, says Executive Director Lim Cheong Guan. Rising costs are "a headache," says Sakae Kubota, managing director of **Okamoto Industries**, Japan's biggest condom maker. However, competition from other brands may limit the company's ability to raise prices, Kubota added. —*Aya Takada and Supunnabul Suwannakij*

The bottom line *Extreme weather in Asia has hit rubber production and has prompted tiremakers and other businesses to raise prices.*

Briefs

by Caroline Winter

Lennar
Profiting from distressed real estate



Lennar, the No. 3 U.S. homebuilder, reported better-than-anticipated results for the third quarter. Profit for the three months ended Aug. 31 was $30 million, compared with a loss of $171.6 million for the same period last year. The Miami-based company's star performer was its Rialto Investments division, which focuses on managing and restructuring distressed real estate assets, including a large stake in a $3 billion portfolio of loans acquired from the Federal Deposit Insurance Corp. in February. Despite renewed signs of life in the market—housing starts were up 10.5 percent in August—Lennar President and CEO Stuart Miller cautioned it's too early "to have a sigh of relief."

Microsoft
Bringing the Zune to Europe



Microsoft is expanding its Zune music and movie download service to Europe, betting that the Continent's more than 10 million users of the company's Xbox games console will help it compete with Apple. Aimed at users of Windows computers, Xbox consoles, and smartphones equipped with the forthcoming Windows Phone 7 operating system, Zune will be available in the U.K., France, Italy, Germany, and Spain this fall. Microsoft also is partnering with local content producers to provide offerings for European markets.

Nissan Motor
May share technology with China

Japan's Nissan Motor is in discussions with its Chinese partner, Dongfeng Motor, about sharing its electric-vehicle technology and jointly producing the Nissan Leaf electric car, says CEO Carlos Ghosn. The talks come as China mulls new rules for how foreign automakers produce and market electric cars and hybrids. Some foreign executives worry that China's plan would require a transfer of knowhow that would mean losing control of their technology.



Seagate Technology
A deal to go private looks unlikely

Seagate, the world's largest marker of hard-disk drives, was in talks with previous owners TPG Capital and Silver Lake Partners about taking the company private again in a $7 billion deal, according to people privy to the discussions. The negotiations collapsed because Seagate wasn't meeting some of the financial goals set by the firms. While buyout firms are on the lookout for targets as the economy stabilizes, there have only been $68.1 billion in leveraged buyouts announced so far this year, vs. $443.6 billion for the same period of 2007.



Blockbuster
Filing for bankruptcy

$900
MILLION

Staggering under the weight of its $900 million debt, Blockbuster was set to file for Chapter 11 protection from creditors at press time. The Dallas-based company intends to use a $125 million loan to reorganize so it can compete with rivals such as Netflix in renting movies online. The restructuring plan calls for a group of senior bondholders—including billionaire investor Carl Icahn, who holds about one-third of the company's bonds—to swap their debt for Blockbuster stock, say people with knowledge of the discussions.

On the Move

Lufthansa Christoph Franz named CEO • **Verizon Wireless** Lowell McAdam named CEO • **UniCredit** CEO Alessandro Profumo resigns • **Astraeus Airlines** Bruce Dickinson of Iron Maiden fame to be head of marketing



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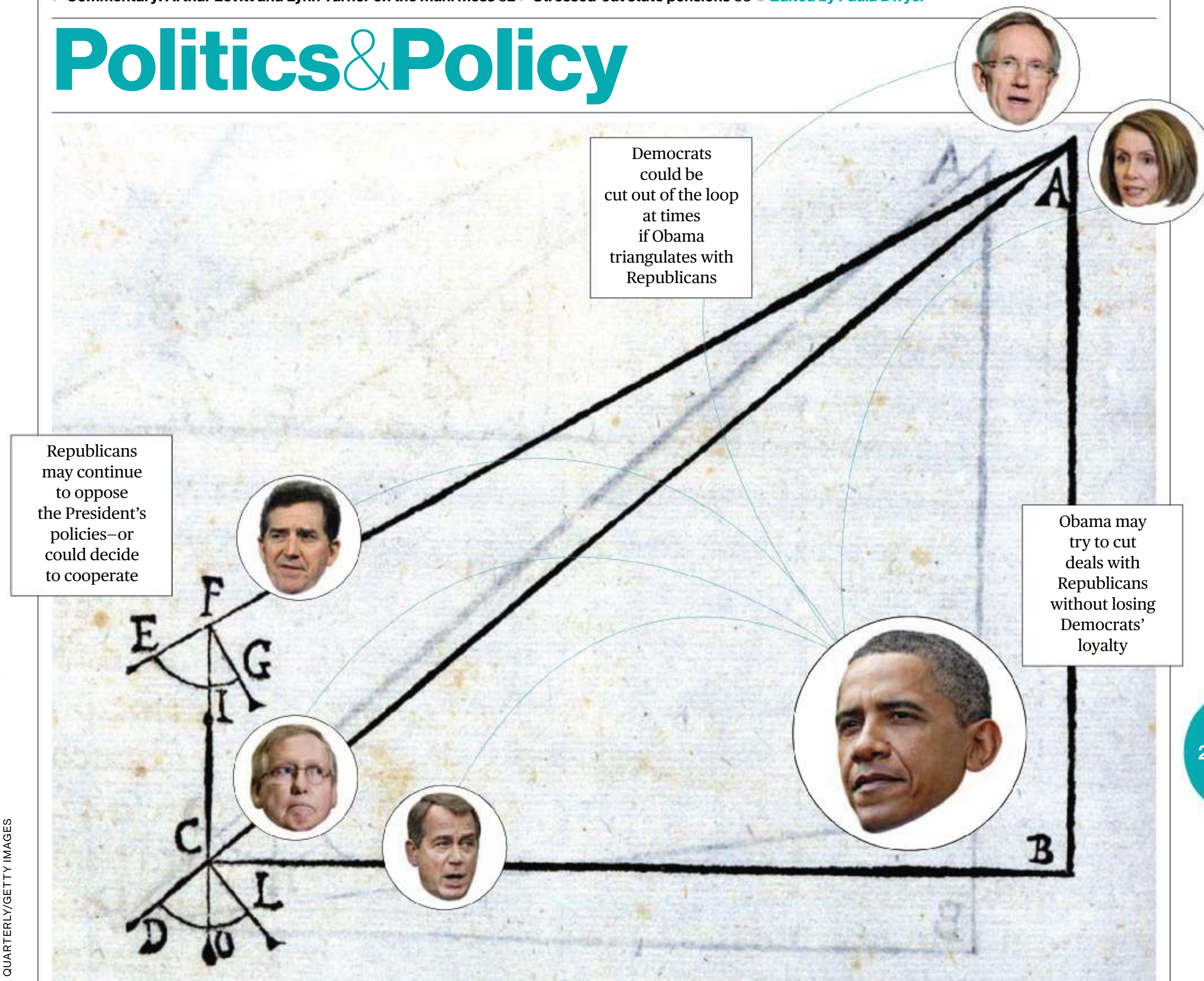


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2011 Will Be a Triangulating Time for Obama

▶ **He may need to revamp his team and agenda to deal with a likely Republican-controlled House**

▶ **"Nobody should be under the illusion that there is an easy path to compromise"**

Flash-forward to late January 2011. A humbled President Barack Obama, putting the final touches on his State of the Union address, ponders offering an olive branch to the new House Speaker, John Boehner. "Should I work across party lines on a budget-balancing deal, or maybe a free-trade accord?" the President muses. "Or should I just make sure my veto pen has plenty of ink?"

To triangulate or not—that's the dilemma Obama will confront if, as nearly every poll now suggests, the Democrats lose control of the House in November and hold the Senate by a nose or two. Past Presidents have sought to avoid gridlock by recalibrating their agendas and governing style and shaking up their teams. Obama may follow suit, though some say the odds of success are slim. "Nobody should be under the illusion that there is an easy path to compromise," says Vin Weber, a Republican strategist and former House member from Minnesota. One reason is that the new Congress is likely to be even more polarized than the current one, dominated by conservative Republicans who challenged party regulars in primaries and won. The Democratic

caucus will be more liberal because it will be mostly swing-state centrists who will lose in November, Weber says.

The recent master of triangulation was President Bill Clinton, who claimed the political center in 1996 with his "frenemies" approach, famously declaring, "the era of big government is over." He went on to score landmark legislation that reformed the welfare system, and he balanced the budget.

So what might such an approach look like this time around? Obama is already remaking his team. On Sept. 21 the White House said Lawrence H. Summers, the director of the National Economic Council and architect of Obama's recovery plan, will return to Harvard University at yearend. His is the third economic team departure, along with budget director Peter R. Orszag and Christina D. Romer, whose replacement as chairman of the Council of Economic Advisers, Austan D. Goolsbee, clashed with Summers over automaker bailouts, which Goolsbee in part opposed. Chief of Staff Rahm Emanuel is also likely to depart, possibly in early October, to run for mayor of Chicago.

The vacancies will let Obama reshape his agenda and address a criticism that the White House, lacking a top West Wing aide with corporate experience, doesn't understand business. Sources familiar with the President's thinking say he's considering adding a corporate ambassador to his economic team. Among those being discussed: Anne Mulcahy, the former **Xerox** chief executive, and Richard D. Parsons, the **Citigroup** chairman and former **Time Warner** head. "I think they are looking for someone who businesses can feel they can talk to," says Martin N. Baily, CEA chairman under Clinton.

It may be easier for Obama to decide on an agenda than a new staff. He would like to rewrite the immigration laws and cap carbon emissions, two pieces of unfinished business. That won't be possible. The focus will have to be more mundane—making sure health-care and financial system reforms are implemented. Republicans, infused with Tea Party passions for limited government, will do their utmost to stymie him.

On Sept. 23, House Republicans were set to unveil their agenda, which will call for a three-day waiting period for citizen review of legislation before a vote. It

Poll

STAT No. 1

59%

Bloomberg Global Poll respondents who named German Chancellor **Angela Merkel** as the leader pursuing the best policies for investment. Chinese President **Hu Jintao** was named by **58** percent, while President **Barack Obama** was chosen by just **32** percent.



will also advocate a certification process to make sure the Constitution authorizes bills and congressional approval of any new regulations. Some Republicans already have staked out their ground—and it's not middle-of-the-road. Representative Pete Sessions (R-Tex.) will try to freeze government hiring to block Obama from bolstering the agencies that will implement the health-care and financial system changes. Senator Richard Shelby (R-Ala.) wants to defang the Consumer Financial Protection Bureau, a centerpiece of the financial revamp.

That doesn't bode well for bipartisan overtures. Still, there could be room for dealmaking. Obama's debt commission, expected to report on Dec. 1, could propose a combination of spending cuts, tax increases, and entitlement reforms attractive to both parties' deficit hawks. "If we're going to confront the fiscal issues of the country," Goolsbee says, "it has to be done in a bipartisan way." If the commission proposes tax reforms that include a consumption tax, a senior Administration official says, Obama would certainly consider it. The enormity of the national debt may be the one thing that spurs Republicans to put aside their differences with Obama, says former House Ways and Means Chairman Bill Archer (R-Tex.). "People are definitely scared," he says.

Free-trade pacts could also open Republican doors. Obama has said he wants to reach a deal on the U.S.-Korea Free Trade Agreement during a November trip to Seoul. And while he is unlikely to seek legislation to create a market for trading carbon credits, he may try to pass energy legislation piecemeal. Republicans may also get behind Obama's recent proposals to expand tax incentives to encourage business investment and to extend permanently a research-and-experimentation tax credit.

Some congressional curve balls could come from Representative Darrell Issa (R-Calif.), who would get the Oversight and Government Reform gavel if Republicans take the House. Issa plans to wield his subpoena authority aggressively, judging by a report he released on Sept. 21 that says he would investigate the $814 billion stimulus bill and Administration claims to have created or saved millions of jobs, among other areas.

The presence of Tea Party-aligned lawmakers could be a new and unpredictable force. Already they are signaling they'll be even more obstructionist than Newt Gingrich, with whom Clinton had to contend. Rectangulation, anyone? —*Paula Dwyer, with Patrick O'Connor, Hans Nichols, and Julianna Goldman*

The bottom line *Losing Democratic control of the House could force Obama to adjust his agenda and seek common ground with Republicans.*

Forget new immigration laws or a carbon cap. Obama will work to implement his health and financial reforms

Alternative Energy

Deficit Hawks Threaten Ethanol's Future

▶ **A tax credit's possible expiration puts producers up against the wall**

▶ **"People are worried about deficits, debt, and special-interest handouts"**

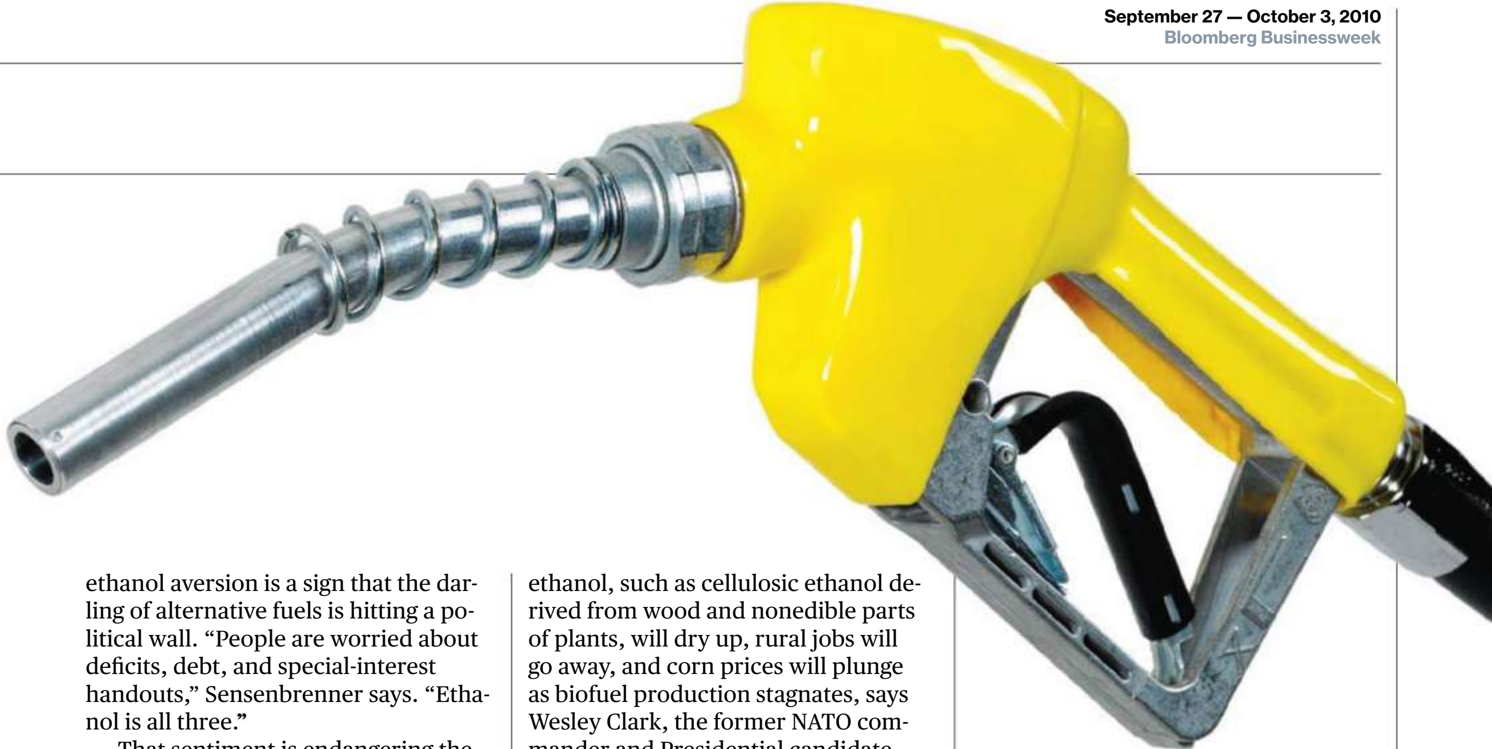
Jim Sensenbrenner pays extra to cruise his pontoon boat across Pine Lake in southern Wisconsin. He's willing to hand over 30¢ more per gallon for gasoline free of ethanol, which he calls "a lousy fuel" that corrodes his two-stroke outboard engine.

One boater's opinion might not matter, except that Sensenbrenner happens to be the top Republican on the House Select Committee on Energy Independence and Global Warming. His

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ethanol aversion is a sign that the darling of alternative fuels is hitting a political wall. "People are worried about deficits, debt, and special-interest handouts," Sensenbrenner says. "Ethanol is all three."

That sentiment is endangering the $27 billion industry that has grown up since federal support began under President Jimmy Carter amid the 1970s energy crisis. Today the U.S. offers a 45¢ per gallon tax credit to refiners that blend ethanol with gasoline. The government also requires gasoline makers to use a steadily increasing amount of the additive, and it imposes an import tariff to deter foreign competition.

The tax credit, worth more than $4.7 billion last year, expires on Dec. 31, as does the protective tariff. If Republicans control the House after the Nov. 2 elections, the renewal of those measures will be in doubt. Ethanol could go the way of biodiesel, an alternative fuel made from soybeans, whose production has ground to a near-halt since biodiesel's $1-a-gallon incentive expired at the end of last year, according to the National Biodiesel Board.

Failure to renew the tax credit would drain a key driver of growth from an industry that has seen at least a dozen companies seek bankruptcy protection in the past two years. That raises the stakes for ethanol makers in a related struggle: persuading the Environmental Protection Agency to allow 15 percent ethanol, up from the current 10 percent limit, in motor fuel blends. Boosting the cap is needed to attract investment in new sources of ethanol that don't depend on a food crop, says Growth Energy, an ethanol advocacy group supported by the top U.S. producer, **Poet** of Sioux Falls, S.D. Without it, investment in next-generation ethanol, such as cellulosic ethanol derived from wood and nonedible parts of plants, will dry up, rural jobs will go away, and corn prices will plunge as biofuel production stagnates, says Wesley Clark, the former NATO commander and Presidential candidate who is Growth Energy's chairman.

The battle over ethanol's future pits the industry, corn farmers, and the U.S. Agriculture Dept. against a growing cadre of environmental groups, cattle ranchers, and deficit hawks like Sensenbrenner. Environmentalists question ethanol's overall benefits, and cattle ranchers say it raises the price of feed corn. **General Motors**, **Ford,** and **Chrysler** worry that ethanol will corrode engines in cars not designed to handle the stronger blend. Some 12.8 billion gallons of ethanol will be produced this year by 201 distilleries, according to the Renewable Fuels Assn. U.S. drivers will use about 138 billion gallons of gasoline.

Ethanol's Corn Belt popularity means many Midwest and rural lawmakers of both parties will back it, says David Yepsen, director of the Paul Simon Public Policy Institute at Southern Illinois University Carbondale. Still, "the whole condition of the nation's finances is changing the equation on federal spending, and that's true when it comes to ethanol," says Yepsen.



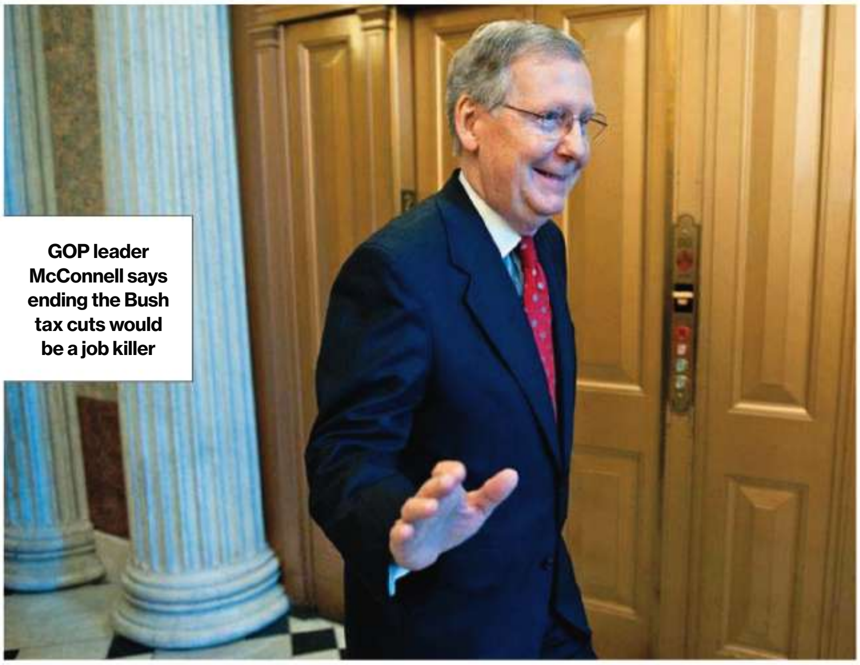
Farmers and ethanol supporters, including House Agriculture Committee Chairman Collin Peterson (D-Minn.), accuse the EPA of foot-dragging on the 15 percent blend limit, which they estimate would create about 136,000 rural jobs. A ruling was delayed last November; the EPA says it will decide after the Energy Dept. finishes tests later this year on whether the fuel has a negative effect on newer vehicles.

Clark's Growth Energy wants the tax credit extended but can accept ending it if the Administration supports ethanol in other ways, such as bolstering the number of fuel pumps, pipelines, and other infrastructure needed to move ethanol from Midwestern distilleries to consumers. Clark seeks to shift political pressure to opponents such as Sensenbrenner, saying they're blocking a chance for the U.S. to kick its addiction to foreign oil. "If he had to justify that to his constituents," Clark says, "he might decide that domestic fuel is pretty good."

—*Alan Bjerga and Mario Parker*

The bottom line *The $27 billion ethanol industry's future is threatened as it loses some of the political support that has sustained it for decades.*

For an interactive chart on proposals for the Bush era tax cuts, go to www.businessweek.com/taxcuts



GOP leader McConnell says ending the Bush tax cuts would be a job killer

Taxes

Will Ending Tax Cuts Hurt Small Business?

▶ Under the Republican plan, Obama and Soros would benefit

▶ "We are being over-inclusive in our use of small business income"

Senate Republican leader Mitch McConnell has thrust small business to the center of the political fracas over extending the Bush era tax cuts. He says President Barack Obama's plan to limit future tax breaks to couples earning less than $250,000 would subject 50 percent of small business income to a tax increase, stalling the job creation engine. McConnell would renew all the cuts, even those for the highest-income U.S. households. The tax cuts expire on Dec. 31 unless Congress acts.

If McConnell has his way, Obama, billionaire investor George Soros, and many film stars would be among the "small business owners" to benefit. Obama last year earned more than 10 times as much from his work as an author as he did from his $400,000 Presidential salary and reported that business income on his personal tax return, the same as a shareholder in a 50-employee machine shop might.

The debate pitting Obama's "no tax cuts for the rich" position against McConnell's "job-killer tax-increases" argument could play out on the Senate floor the week of Sept. 27, although a resolution is not likely until Congress returns for a lame duck session after the election. Which side is right? Recent studies by two nonpartisan groups suggest that McConnell, of Kentucky, is exaggerating. Yet the IRS doesn't collect the information needed to pinpoint who would pay the higher taxes, a data gap that allows both sides to claim the rhetorical high ground.

McConnell's 50-percent-of-income figure is based on a July 12 finding by the Joint Committee on Taxation, a House-Senate panel that analyzes tax issues, that half of about $1 trillion of business income in 2011 will be reported on some 750,000 personal tax returns filed by people who pay the top marginal rates. He calls those small businesses. Yet the report says the data "do not imply that all of the income is from entities that might be considered 'small.'" Almost 20,000 of those businesses, for example, had receipts of more than $50 million, it says.

Besides Obama, McConnell's 50 percent figure includes authors, actors, athletes, and others who employ few if any workers, as well as hedge fund firms and major law partnerships most people wouldn't consider small. "We are being over-inclusive in our use of small business income," says Edward D. Kleinbard, a former staff director of the Joint Committee on Taxation who is now a University of Southern California law professor.

Obama doesn't address the effect of his plan on small business income. Instead, he says his plan would hit only about 3 percent of all small businesses, also a joint tax committee number. Republicans counter that those 3 percent generate most of the real small business activity. "The last thing you would want to do is raise taxes in the middle of a recession on our most productive small businesses," McConnell said in a Sept. 15 Fox News interview.

The confusion stems from the IRS's inability to determine if the income on a tax return comes from a small or large business. The dispute revolves around three types of businesses–partnerships, sole proprietorships, and so-called S corporations, which often have one or two shareholders. These structures are popular because they allow profits to be reported on business owners' personal tax returns without first going through a layer of corporate tax.

The nonpartisan Congressional Research Service, which analyzes issues for lawmakers, largely agreed with Obama in a Sept. 3 report that considered only taxpayers with employees. Its conclusion: Small businesses with actual workers would pay only about 12 percent of the higher taxes. "Across-the-board tax cuts for high-income individuals are not efficiently targeted to small businesses," wrote author Jane G. Gravelle. —*Ryan J. Donmoyer*

The bottom line *Some small business income would be subject to higher taxes under Obama's plan, though not the 50 percent the GOP claims.*

Poll — STAT No. 2

33%

Bloomberg Global Poll respondents who named **China** and **Brazil** as the best markets in which to invest. **India** was close behind, named by **31** percent. The U.S. came in at **24** percent. Investors had listed the U.S. higher than all three emerging markets in a June poll.



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Don't let the bedbugs bite
page 40 ▶

Supreme Court

The Case of the Missing Justice

▶ Kagan has disqualified herself from more than half the court's docket

▶ Consumer advocates would "rather have her there ... she'll be missed"

Elena Kagan may make her mark in her first U.S. Supreme Court term less by her presence than by her absence.

Kagan has disqualified herself in 20 of the 38 cases on the court's calendar this term because she took part in the litigation as U.S. Solicitor General. The 20 include some of the most important business cases: a fight over sanctions on employers for hiring illegal aliens, a clash between manufacturers and discount stores over the multibillion-dollar trade in imported "gray market goods," and disputes over consumer suits against automakers and drug companies.

In each case, Kagan's absence creates the prospect of an evenly divided court, an outcome that would leave the lower court ruling intact without setting a nationwide precedent. "You could have a 4-4 affirmance that will be satisfying to no one," says Roy Englert, who represents **Costco Wholesale** in the import case.

That may hurt the U.S. Chamber of Commerce's bid to overturn an Arizona law that threatens businesses with revoking their corporate charters if they hire illegal aliens. A federal appeals court upheld the measure, which labor and civil rights groups are also challenging. They say the law infringes on Congress' exclusive authority to regulate immigration. "I'm still hoping that our argument is strong enough that it won't split 4-4, but losing Kagan complicates the case," says Carter Phillips, who will argue the case on behalf of the law's challengers.

Should the court muster a five-justice majority, the case could affect alien employment laws in dozens of states and the Arizona law that requires police to detain undocumented immigrants.

In the drug and auto cases, Kagan's absence may work to the advantage of business, depriving consumers of the fifth vote they need to revive their suits. In each case, a lower court said federal law insulates manufacturers from product liability suits. The drug case involves two parents seeking to sue **Pfizer**'s Wyeth unit over a vaccine they blame for their daughter's seizure disorder and mental impairment. In the auto case, the family of an accident victim claims **Mazda Motor** should have installed a better seat belt in a 1993 minivan. Consumer advocates hope Kagan will follow the lead of her predecessor, retired Justice John Paul Stevens, who tended to reject arguments that federal law preempted such liability suits. "I'd rather have her there," says Public Citizen's Allison Zieve, speaking about the vaccine case. "That's one where we expect she'll be missed."



As for the import case, retailers may be better off without Kagan, though they will need five votes to overturn a lower court ruling favoring manufacturers. The dispute turns on efforts by discounters to exploit lower overseas prices by buying products abroad and importing them for sale in U.S. stores. As Solicitor General, Kagan defended a ruling letting manufacturers use copyrights on their products to block the discount chains.

Kagan probably will take part in more cases next year during the second half of the nine-month term, says Tom Goldstein, whose Scotusblog website tracks the court. And even when her recusal causes a 4-4 split, she might be able to consider the issue–and resolve the divide–in a later case. "In the sort of broad arc, it's not that big a deal," Englert says. Still, on a court that often cleaves down the center, with Justice Anthony Kennedy casting the deciding vote, Kagan's empty chair will be significant in the coming months. "Not having Kagan shifts the middle of the court from Kennedy to who knows," Phillips says. "That can make a huge difference in some cases." ⓑ —*Greg Stohr*

The bottom line *Kagan's absence raises the prospect of an evenly divided court on several cases important to business.*

Immigration

Can Arizona enforce a law that puts businesses at risk of losing their corporate charters for hiring illegal aliens? The case could have implications for the U.S.'s challenge of a separate Arizona law that requires police to detain people without documents. Argument in *Chamber of Commerce v. Whiting* is Dec. 8.

Kagan won't participate.

Auto Safety

Can accident victims sue automakers for not installing safety devices beyond those required by federal law? *Williamson v. Mazda Motor of America* concerns a claim that Mazda should have installed a safer seat belt in a 1993 MPV minivan. Argument is Nov. 3.

Kagan won't participate.

Gray Market Goods

Can manufacturers use copyright laws to keep their own foreign-made products off the shelves of U.S. discount stores? *Costco Wholesale Corp. v. Omega SA* might reshape the multibillion-dollar "gray market," in which goods bought overseas are sold in the U.S. at discount, bypassing a company's authorized distribution channel. Argument is Nov. 8.

Kagan won't participate.

Video Games

Is a California ban on the sale of violent video games to minors constitutional? A lower court said the ban infringed on free speech rights. Argument for *Schwarzenegger v. Entertainment Merchants Assn.* is Nov. 2.

Kagan will participate.

Poll

STAT No. 3

71%

Bloomberg Global Poll respondents who gave Federal Reserve Chairman **Ben Bernanke** a favorable rating. A majority, **57** percent, also said the Fed's policies have been about right.



DATA: The Bloomberg Global Poll, conducted Sept. 16-17, is based on a random sample of 1,408 Bloomberg customers who are investors, traders, and analysts on six continents. The margin of error is plus or minus 2.6 percentage points.

Arthur Levitt Jr. and Lynn E. Turner

How to Clean Up The Muni Bond Market



Defaulting bonds, unfunded liabilities, fraudulent investment information—let's fix the public pension fund mess before it's too late

The municipal bond market, once a quiet corner of Wall Street, is slowly becoming a scene of scandal and regulatory inquest. The Securities and Exchange Commission recently accused New Jersey of giving fraudulent information about its finances to municipal bond investors. The SEC is investigating officials in Miami for similar problems. The rate of municipal bond defaults—roughly $3 billion per year—is triple the usual pace, and analysts say many more bonds are on the brink because of the weak economy and low tax collections.

Should investors worry about their municipal bond portfolios? In most cases, no. The vast majority of municipal bonds pay off on time. Major disasters have been rare and confined.

That record of relative calm is a key reason munis have been spared the kind of regulatory attention given to their corporate bond cousins. In our view, that special treatment serves investors in municipal bonds poorly, leaving them underinformed about some of the risks they are taking. In the end, the biggest losers will be municipal bond issuers themselves, imperiling their ability to borrow at low rates in the future.

At the core of the problem are questions about how governments manage pension funds, what investors know, and when they know it. The case against New Jersey revealed that the state has made unfunded pension fund promises to its employees, and compounded the problem by not being forthright with bond investors. (The state settled without admitting wrongdoing.) In this case, the contrast between the corporate and municipal markets could not be sharper.

Pensions typically keep up with benefit promises through a combination of worker contributions, employer contributions, and market returns. But those have slowed to a trickle as states have cut back on their own contributions, employees have contributed too little, and hoped-for investment gains have disappeared. Most pension funds operate with an assumption that they can return an annual 8 percent or better on their money. In the last decade, the Standard & Poor's 500-stock index has returned around zero.

Pensions suffer from the same demographic ills as Social Security. The workforce is aging, people are living longer, and they are often retiring earlier—so benefits are getting more expensive to sustain. These problems afflict corporate and public pensions equally. Because of pension fund rules, corporations are required to step up contributions when their pension funds fall behind. Perhaps more important, they have to disclose their underfunded pensions to their investors in regular public filings.

Public pensions play by different rules. Most are under no obligation to keep their public pensions fully funded. Legally, government officials can keep their pension liabilities either under wraps in delayed filings or cloaked in opaque documents investors are unlikely to see or understand. Many pensions proclaim themselves healthy by virtue of past investment performance that is unlikely to continue and that may have already been undermined by more recent market losses.

Only because of dogged investigations did taxpayers, workers, and investigators discover that New Jersey stopped making pension fund contributions. The state said that prior year gains were enough to cover future benefits.

Meanwhile, government officials and labor unions have reopened pension agreements every few years, often agreeing to improve them for workers, usually through cost-of-living increases above inflation and options to "purchase" years of service toward pension payouts.

These pension fund problems could become a headache for municipal bond investors eventually. After all, any long-term problem facing states, cities, and other governments will end up harming their ability to pay their regular debts.

How big is the problem? Some estimate that unfunded retirement liabilities have grown to anywhere from $1 trillion to $3 trillion. Current retirees will still have their benefits, but the security of future retirees is in doubt.

This is not a problem with an easy solution. If states turn to taxpayers to backfill their pension liabilities, the tab could be huge: In Colorado, with 5 million citizens, the likely cost is now over $5,000 for every man, woman, and child, or three times the annual state income tax bill for a family with $40,000 in income.

Shutting down the plans would make things worse. The incoming funds from current workers keep the system's cost from being shifted entirely to the shoulders of taxpayers. Forcing public workers into 401(k)s won't work, as those are often more underfunded than pensions.

Nor can states and localities cancel their past commitments. Courts have taken a dim view of such unilateral moves.

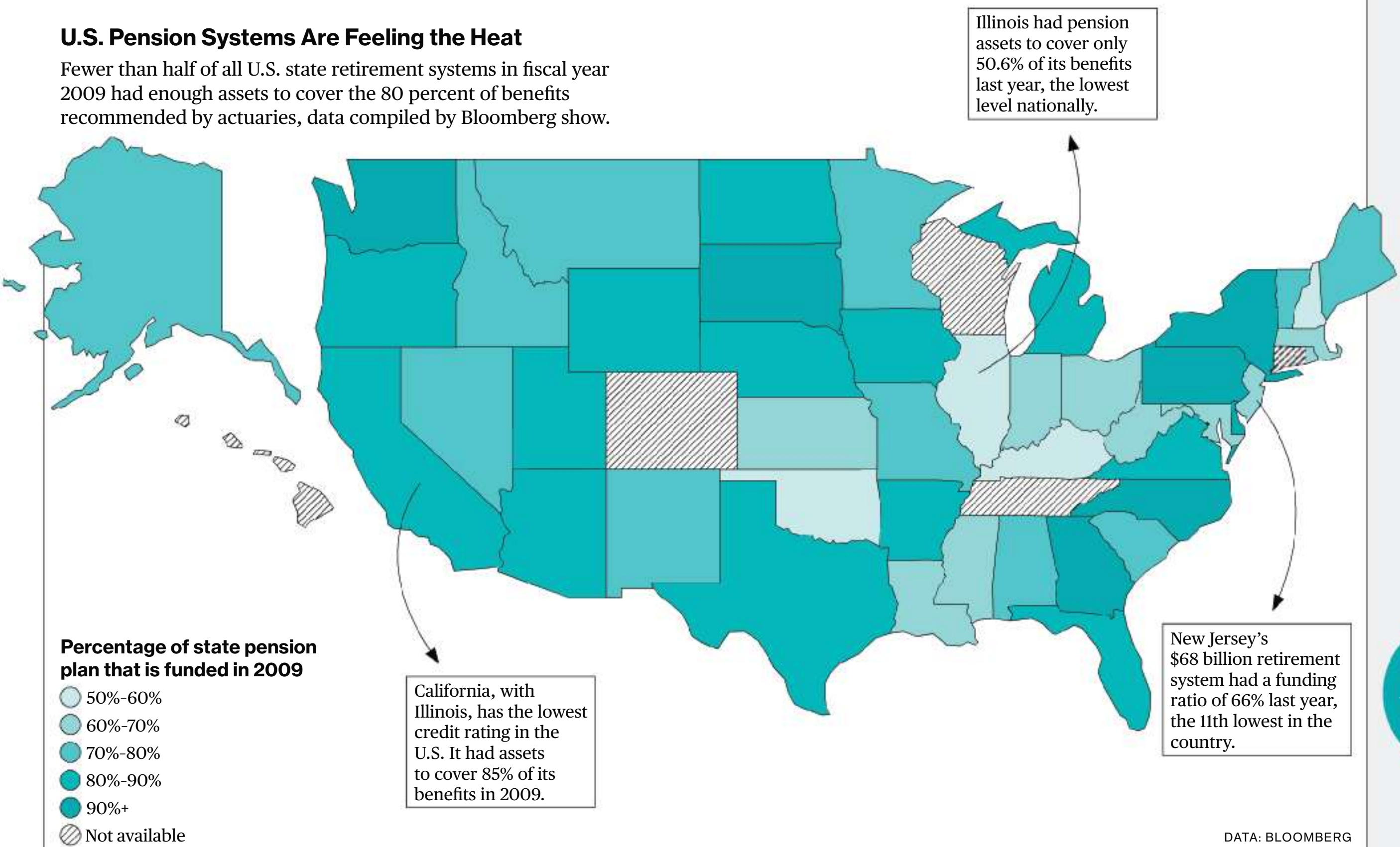
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U.S. Pension Systems Are Feeling the Heat

Fewer than half of all U.S. state retirement systems in fiscal year 2009 had enough assets to cover the 80 percent of benefits recommended by actuaries, data compiled by Bloomberg show.



DATA: BLOOMBERG

The solutions, alas, can't be put off, either. Everyone involved–government employees, employers, and taxpayers–will have to share the pain. Here are the five essential steps for reform:

1. Congress must force states and other public agencies to admit their pension problems in timely, audited, plain-English reports using standards similar to those used by corporate pensions.

2. The SEC has the power it needs to enforce securities laws–except when it comes to the municipal bond market. For this reason, Congress should repeal the 1975 Tower Amendment, which prevents the SEC from having the same regulatory authority over the muni bond market that it has over its corporate counterpart. Such a repeal would allow the SEC to require that municipal bond offering documents be similar to those in corporate offerings, that governments follow uniform accounting standards defined by an independent board, and that ratings agencies apply the same standards to government and corporate debt instruments.

3. Even within its limited existing authority, the SEC should be more aggressive. The New Jersey case, for example, was resolved with no fines and without disclosure of the names of those responsible.

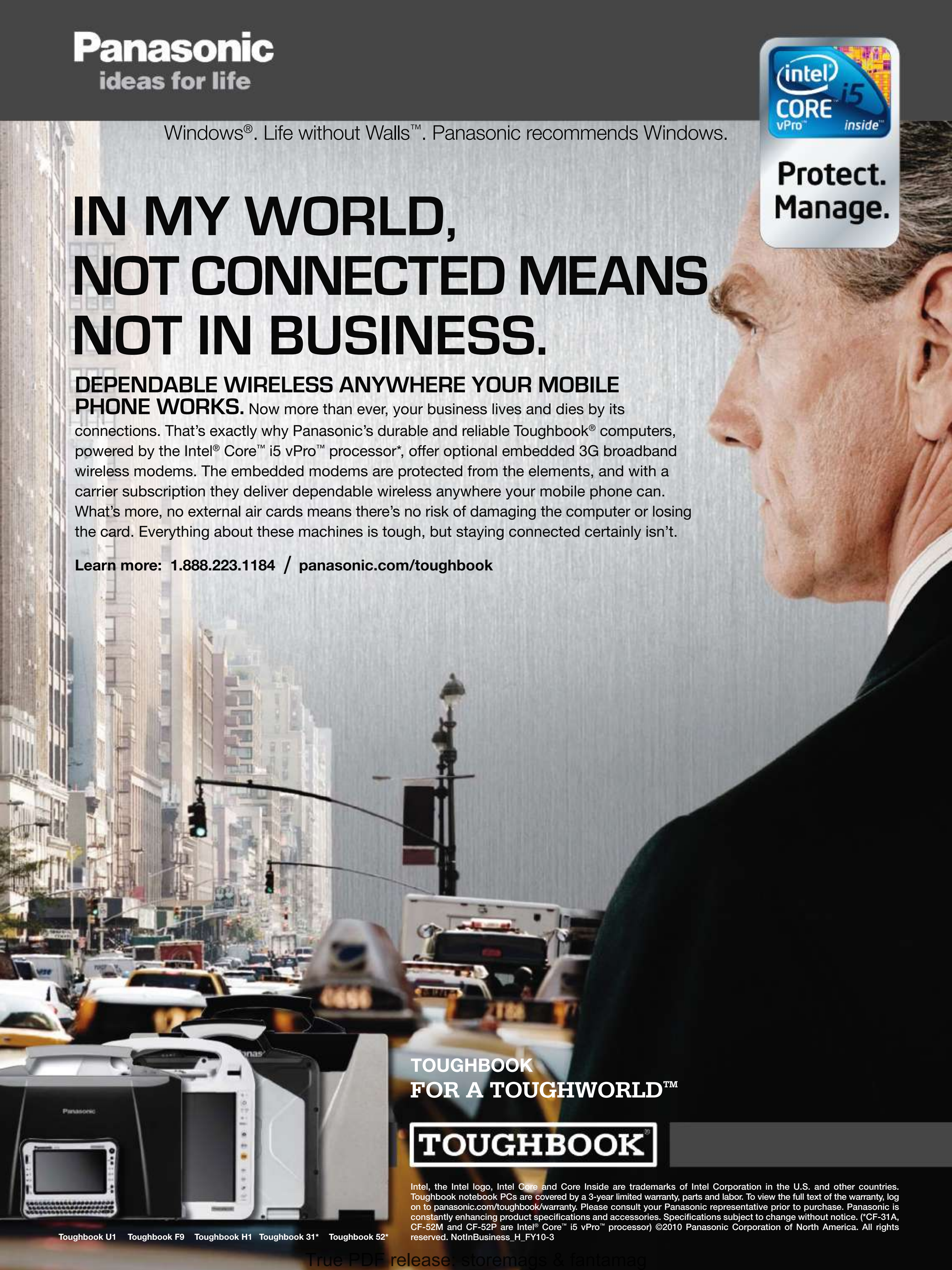
4. Congress should require that public pension fund boards adopt the same governance principles as companies. This would include greater disclosure and a majority of independent board members who can fulfill their fiduciary responsibilities to the employees in the plans. While neither of us regards corporate pensions as a picture of health, at least retirees, regulators, and investors are regularly updated on their condition, and companies are routinely forced to fund future benefits as market conditions change. That comes out of a truly independent audit.

5. Finally, states and localities should be permitted to sweeten benefits only if they agree to fund them fully. That will keep politicians from making more promises they can't keep.

The key to these reforms is the leverage of the marketplace, where investors make cold-eyed calculations of their risks. They need to be able to figure out which bond issuers are most likely to default due to pension fund obligations–and charge them more to borrow further. While that will be a harsh penalty for some states and localities, it may be the only way to save this market from ruin.

The stakes are really that high. For decades, the municipal bond market has allowed governments to build needed public infrastructure projects and fund operations affordably. If investors discover that the market has instead become a way to paper over irresponsible promises, they will flee it. And no state, county, or local government will be spared the damage that follows. B

Levitt, former chairman of the SEC, is a senior adviser at the Carlyle Group, a policy adviser at Goldman Sachs, and a director of Bloomberg. Turner, former chief accountant of the SEC, is a senior adviser at consulting firm LECG. The views expressed are their own.



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Technology

On YouTube, Seven-Figure Views, Six-Figure Paychecks



Mystery Guitar Man wanders the desert for Garnier Fructis

DeStorm Power helps Pepsi pop

Rhett & Link get playful with Carpenter's pillows

The Gregory Brothers tune up Sony

Smosh clowns around with Butterfinger

▶ YouTube stars land sponsorships, cut ad deals, sell stuff, and become semi-rich

▶ "These guys are no different than creators working in television and film"

Rhett McLaughlin and Link Neal, the 32-year-old comedians known professionally as Rhett & Link, wanted to be television stars. They were on the verge three years ago when The CW network canceled their variety show after four episodes. That's when they started building a business centered on **YouTube** videos. Two years ago they persuaded a toy company called **AJJ Cornhole** to sponsor a music video—an ad, really—about a beanbag-tossing game. Although the video generated more buzz than money, it led to more work. Since then, Alka Seltzer, **McDonald's**, the **Food Network**, Cadillac, and other brands have sponsored Rhett & Link videos.

McLaughlin and Neal have become part of an elite group that's making good money off their YouTube videos. Earlier this summer the Web analytics company **TubeMogul** released a study estimating that the top indie video producers on YouTube earn north of $100,000 in annual advertising revenue alone. Although the video-sharing site may not be minting millionaire entertainers yet, six-figure incomes are within reach for the most industrious creators.

So far in 2010, Rhett & Link videos have averaged 119,457 views per day, according to TubeMogul. "What really sets them apart—lots of YouTube celebrities have more daily views—is their leadership in doing branded integration," says David Burch of TubeMogul. "No YouTube celebrity other than [cosmetics guru] Michelle Phan has more branded views in 2010, according to our estimates." By branded integration, Burch means sponsorships. In some Rhett & Link videos, products appear on-screen. In others, the name of the company is flashed at the end. Their latest opus is a music video produced for **Carpenter**, a cushioning manufacturer. (Sample lyrics: "Do you remember back in middle school/When my trunks fell down at the pool/Everyone laughed, except for you/You just let me hold you in my bedroom/My favorite pillow … My favorite pillow …") At the end, the name of a Carpenter-owned sleep-advice website appears.

During its first week online, the pillow song was viewed more than 2 million times and generated more than 16,000 comments. "As we've come along, we've educated our audience, getting them to understand that brands do not compromise entertainment," says McLaughlin. "For us, they enhance it. They enable it." They also enable McLaughlin and Neal, who are both married with children, to support their families.

Rhett & Link get two streams of income from YouTube. Aside from the sponsorship money, which is all theirs, they receive advertising income because Rhett & Link have been designated an official YouTube partner. Creators must apply to become partners,

A luxury travel club's trip to bankruptcy page 44 ▶

and so far about 10,000 have been accepted. Members get a cut of the ad sales on their channel. The ads are sold by **Google**, which owns YouTube. The only thing McLaughlin will say about Rhett & Link's income—YouTube partners are contractually forbidden to discuss their ad earnings—is that he and Neal are no longer scrambling for survival. "We're in a place now where we don't have to constantly be pursuing a project every couple of weeks to make a living," he says. "We can be choosier."

For most, the YouTube partner program doesn't provide enough to survive on. So video makers hustle on multiple fronts: They sell T-shirts and mugs to fans on their YouTube pages. Musicians use videos to sell songs on iTunes and tickets for live gigs. Artists list P.O. boxes on their pages, and fans and companies send them free electronics, Snuggies, and other stuff. "That's another form of income," jokes DeStorm Power, a Brooklyn (N.Y.) YouTube star who creates R&B music videos.

McLaughlin and Neal sell Rhett & Link-branded shoes on their YouTube site. "In our experience, the merchandise sales can add up to a significant amount of money. But I don't see how you could do it without the direct sponsorship," says McLaughlin. "We were doing sponsored videos before we became YouTube partners. We just see [the additional revenue] as gravy."

Top YouTube entertainers usually command flat fees in the five-figure range for their sponsorships. Rhett & Link negotiate their own deals. "The rules of this game are being created as we go along," says McLaughlin. "Sometimes you ask a price and people laugh in your face, and sometimes they say, 'Yes,' and you're like, 'Hmmm, maybe we should have asked for more money?'"

Earlier this year, DeStorm Power won a video-making contest run by **Wonderful Pistachios**. In Power's 30-second spot, he sings and plays percussion with pistachios. The video won him a lifetime supply of pistachios, a camcorder, and $25,000. That helped set his sponsored-video fee for clients such as **PepsiCo** and **General Electric**. "Once you do something, you don't want to go backwards," he says. "You have to keep the scale around where it is."

Not all YouTube stars want to handle their own business negotiations. "I wanted to focus on the creative side," says Michael Gregory, a Brooklyn musician whose band, the Gregory Brothers, leapt to YouTube stardom with its Auto-Tune the News series. He teamed up with a company called Next New Networks, a web-video development company in New York. The company manages performers' sponsorships, negotiates ad deals with Google, and handles audience development and public relations. Next New Networks represents about 50 artists who collectively generate more than 150 million monthly views. "These guys are no different than creators working in television and film," says CEO Lance Podell. "They're looking for fame and fortune."

Rhett & Link plan to follow the opportunities wherever they arise. "We want to do it all," McLaughlin says. "But we don't ever want to neglect the Web." —*Felix Gillette*

The bottom line *Thanks to ad revenue-sharing deals and corporate-sponsored videos, top YouTubers can earn well north of $100,000.*

Let's Make a YouTube Deal



Pepsi

Singer DeStorm Power was commissioned to plug the Pepsi Refresh Project, a philanthropic social media campaign, by playing percussion on Pepsi soda cans and bottles and singing about "refreshing the world."



Sony

The Gregory Brothers reedited an electronics commercial made for television into a musical sendup featuring a Ping-Pong showdown between Peyton Manning and Justin Timberlake.



Garnier Fructis

Mystery Guitar Man (singer-songwriter Joe Penna) promoted Garnier's new Survivor Gel hair-styling "glue" with a video that involves guitar-picking the spines of a barrel cactus.



Butterfinger

The comedy duo Smosh, aka Ian Hecox and Anthony Padilla, made a sponsored video for Butterfinger SnackerZ called "Selling Out?!" It's about ... making a sponsored video for Butterfinger SnackerZ.

Social Networks

Twitter's Redesign Ruffles Feathers



▶ **Developers who work with Twitter worry it may become a competitor**

▶ **The company needs to "be clear about what is fair game"**

On Sept. 14, Twitter unveiled a redesign of its home page. Before, users of **Twitter** could see and send only text. The new look displays photos, videos, maps, and other extras in the stream of content. Users raved: A scan of Twitter updates about the redesign revealed mostly glowing comments about the new features.

Many Twitter users rarely interact with the home page, however. A whole ecosystem of companies has sprung up around the service, which allows its 145 million users to send 140-character messages, or tweets. Outside software developers have built 250,000 applications using Twitter's technology. Some are downloadable software programs that let users send and receive messages from their smartphones or PC desktops rather than Twitter's home page. Others are ad networks that help marketers reach users. Still others aggregate billions of tweets and use that database to discern trends or consumer sentiment, a field called social media analytics.

Although the number of companies building third-party applications has grown large, the vast majority of them still generate little revenue. Only about 6 percent charge users for a product, according to **Oneforty**, an online repository for Twitter apps. Still, some are in the early stages of creating viable businesses. **UberTwitter**, a mobile application for BlackBerry users, has begun charging marketers thousands of dollars for ads inserted into users' Twit-

CLOCKWISE FROM TOP LEFT: ALFRED SAERCHINGER /CORBIS; ILLUSTRATION BY TOPOS GRAPHICS; PHOTOGRAPH BY JASON GROW FOR BLOOMBERG BUSINESSWEEK; BUTTERFINGER: PRNEWSFOTO

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ter streams. **Twitpic**, one of a few sites that store the photos posted in Twitter status updates, says it will see revenues of $10 million this year from ads displayed on its photo pages.

Twitter's recent moves have outside developers worried that a bigger, better Twitter will mean fewer opportunities for them. In April the company launched "promoted tweets," a sponsorship program that competes with ad networks like **Ad.ly** and **140 Proof**. The recent redesign added features to Twitter that had once been the province of outside applications such as **Seesmic** and **Tweetdeck**, two popular desktop software programs.

Twitter-reliant startups are trying to divine where the micromessaging service will go next. "Now you look at an opportunity and say, 'What is the likelihood of Twitter trying to do that at some point in the future?' " says Jeff Clavier, whose Palo Alto (Calif.) venture capital firm, **SoftTech VC**, backed Seesmic. John Borthwick, who, as chief executive officer of New York City startup incubator **Betaworks**, invested in many Twitter-dependent companies, now won't consider funding startups based solely on Twitter. "It's reasonable to conclude that any feature ... could be included in Twitter.com," he says. According to private-company researcher CB Insights, investors like Borthwick spent 52 percent less money supporting Twitter-related startups in the year ending in May 2010 than they did in the previous year.

Twitter is likely eyeing the nascent field of social media analytics, says Joe Fernandez, founder of **Klout**. His company is one of dozens that slice and dice the data created by the countless interactions between Twitter's users. For example, Klout uses data to help marketers identify the Twitter users who are most influencing online discussions about their brands. Twitter recently brought on several social media experts, which leaves Fernandez with "no doubt they're going to do an analytics product." He's preparing by building a suite of tools specialized for marketers and salespeople, niches he thinks Twitter will avoid in favor of the mass market.

One reason for the worry among developers and investors is that Twitter doesn't do a good enough job of broadcasting its intentions, says Clavier. Before the redesign, Twitter worked with 16 partners, including **Google**'s **YouTube**. The broader developer community was left guessing whether and how changes at Twitter would affect their businesses. "What they need to do is be clear about what is fair game," says Clavier. Twitter hosts events to share information with its partners, but the company confirms that at the last one, in April, it said nothing about its upcoming redesign.

CEO Evan Williams says the redesigned home page will boost the number of Twitter users, which will be good for its partners. "People would probably use more third-party apps if we can get them started using Twitter," he says. Noah Everett, the founder of Twitpic, is optimistic that the redesign will be good for his company. He concedes, however, that Twitpic is not in the driver's seat, "Twitter owns the platform," he says. "They control it."
—*Douglas MacMillan*

***The bottom line** Twitter grew partly by relying on outside developers. As its features increase, however, it is competing with some of those developers.*



Morgan says Skyhook's deal with Motorola got Google's attention

Legal Fights

Don't Be Evil (or Commit Tortious Interference)

▶ **Skyhook Wireless sues Google for scaring away its business**

▶ **The case "could be very damaging. I mean, it sure sounds evil to me"**

Skyhook Wireless Chief Executive Officer Ted Morgan says that as he finalized a contract with **Motorola** in April, he gave the phonemaker's executives a warning: Expect some fireworks from **Google** when the deal is announced. Motorola's forthcoming smartphones would use Skyhook's software, which helps pinpoint a phone's location, instead of Google's version of the technology. While Motorola handsets would still be based on Google's Android operating system, Skyhook—not Google—would collect much of the minute-by-minute data on the whereabouts of millions

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Technology

of Motorola customers. Because Google hopes to make billions by sending ads to individuals based on whether they're at the ball game or in a grocery store, that information is gold.

The fireworks turned out to be more like a bunker-busting bomb, judging from a lawsuit filed by Boston-based Skyhook against Google on Sept. 15 in Massachusetts state court. Skyhook seeks tens of millions of dollars for actual damages and an end to what it says is Google's "intentional interference" in contracts that scared away Motorola and other unnamed Skyhook customers. In the suit, Skyhook alleges that Andy Rubin, who runs Google's Android unit, told Motorola CEO Sanjay K. Jha that Skyhook's technology, which had never raised concerns before, was not compatible with Android. Rubin said Motorola could not ship any Android phones that used Skyhook software unless they contained Google's location technology, too, according to the suit. In July, when Motorola began selling the first phones that were supposed to fall under the Skyhook contract, the devices didn't contain a line of Skyhook code. (Skyhook also filed a federal patent suit, claiming that Google copied aspects of its technology.)

The allegations fly in the face of "don't be evil," Google's oft-spoken pledge that it believes in, among other virties, technological openness. Since

30%

Android's projected share of the smartphone market in 2014

Android launched in late 2007, Google has said that anyone is welcome to create technologies or products based on the software and that the company won't discriminate to help its own products. "The idea that Google strong-armed phonemakers at the expense of some poor little company could be very damaging," says Forrester Research analyst Charles S. Golvin. "I mean, it sure sounds evil to me." Motorola and Google declined to comment on the lawsuit, though Google spokesman Aaron Zamost says the company's compatibility test is to "ensure a consistent experience" for users and developers. (For an interview with Google's Eric Schmidt, see Charlie Rose, page 39.)

In the past year, Android has blossomed from an intriguing experiment into a hit. Google's Android partners shipped more phones than Apple in the first half of the year, and Gartner predicts Android will grab 30 percent of the market by 2014. This growing mobile power comes as Google faces greater regulatory scrutiny in the U.S. and abroad, most recently an antitrust inquiry by Texas' attorney general over its Web-search practices.

2,138

YEARS

Amount of time people worldwide collectively spent playing the video game Halo: Reach during the week after the game's Sept. 14 release.

DATA: BUNGIE

In 2003, when few phones had GPS capabilities, Skyhook devised a way to determine a phone's location by its proximity to Wi-Fi hotspots. By hiring hundreds of people to drive around in cars rigged with Wi-Fi-detection gear, it has since built a database of 250 million hotspots around the world. While GPS is more accurate than Wi-Fi tracking, it doesn't work in skyscrapers or downtown concrete canyons where buildings block the signal. After talking briefly to Skyhook about a licensing deal, Google focused on developing a similar capability. Today, Skyhook charges roughly 50¢ per device for the technology; Google gives its software away. Morgan says phonemakers are willing to pay for Skyhook because the technology is more accurate. Jeff Rath, an equity analyst with investment bank Canaccord Adams, has another explanation: "They're not Google. That's become a selling

FROM TOP: KEVIN LORENZI/BLOOMBERG; BRAD TRENT

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Charlie Rose talks to
Eric Schmidt



Google's CEO on the power of Facebook, the rivalry with Apple (where until recently he sat on the board), and trying to do the right thing in China

PHOTOGRAPH ILLUSTRATION BY CREDIT TK

How does Google see the future?
There's such an overwhelming amount of information now, we can search where you are, see what you're looking at if you take a picture with your camera. One way to think about this is, we're trying to make people better people, literally give them better ideas—augmenting their experience. Think of it as augmented humanity.

What's the challenge from Facebook and social networking?
At the moment, the two companies coexist quite well. But social networking is important, and Facebook is a consequential company. The more we know about what your friends do, with your permission—and I need to say that about 500 times—we can use that to improve the experience of getting information you care about. We're actually building social information into all our products.

But people are saying, for example, in e-commerce, that you're more likely to be served by the opinions of 10 friends than by a Google search.
If that's the future, we'll see. We can certainly make our advertising much more effective to the degree we have more information about who your friends are. The fact is, there's not going to be a single solution here.

And the phenomenon of Zynga, what does that say to you?
People are willing to spend an awful lot of money on fake animals.

You no longer serve on the Apple board. It is said Steve Jobs got very upset with you, his friend. I didn't go into the search business, he said. Why are you going into the phone business?
Apple is a company we both partner and compete with. We do a search deal with them, recently extended, and we're doing all sorts of things in maps and things like that. So the sum of all this is that two large corporations, both of which are important, both of which I care a lot about, will [remain] pretty close. But Android was around earlier than iPhone.

The operating system was around.
That's correct.

Given the app gap, how does Android compete with the iPhone?
The iPhone established a whole new category, but ... the Apple model is closed. Same hardware, same applications, same store—a so-called vertical stack. All the other vendors want an alternative, and Apple is not going to give it to them. Along comes this Android operating system, which is a complete turnkey solution with similar capabilities. Most important, we make the software available for free. So all of a sudden, Android becomes very popular with companies like Motorola and LG. We now have more than 200,000 of these phones being turned on every day—in 59 countries. We think Android will end up being one of the small number of very successful mobile devices.

What's Android's market share?
Well, we don't really know. What we do know is it's growing phenomenally fast.

Where is the world of apps going?
The Google model is called open-Web applications. There's another model Apple is pushing, which are these iPad applications. The iPad apps are beautiful but highly restrictive. They're written in a specific programming language; they're not Web applications. Over the next few years it should be possible using so-called open technologies to build apps as powerful as those on the iPad but do them on the Web, which means they'll run everywhere.

How far off is that?
The technology is there, and people are developing it. Ultimately, in the Internet, openness has always won. I cannot imagine that the current competitive environment would reverse that.

Where will mobile be in five years?
Today, a powerful touchscreen phone costs about $150. With subsidies it can get down to a small number of dollars. So in five years, that phone can be essentially given away in developing countries. That means we can sell billions of them. The higher-end phones will be approaching supercomputers.

What did you learn from Google's experience in China?
The thing you learn about China is... Chinese citizens are very clever, very creative, and the Chinese government is very, very powerful.

So you didn't change government censorship policies by being there?
The evidence is clear that our entry did not alter censorship policies whatsoever. Negotiating, Charlie, doesn't work with the Chinese.



Watch Charlie Rose on Bloomberg TV weeknights at 8 p.m. and 10 p.m.

Technology

point for companies that want independence from Google's big machine."

Morgan says Google never stood in the way until Motorola announced its Skyhook deal. That's when Rubin called Jha about Skyhook compatibility issues, Skyhook alleges. Morgan says his team tweaked its software to make sure it conformed to Google's specifications, "but we never heard back from Google."

If Skyhook loses its suit, it's essentially cut out of the Android market. If it wins, it still faces a tough market. Although the company has won contracts with **Dell**, **Hewlett-Packard**, and **Samsung**, it has lost the source of over half its sales: **Apple**. While Skyhook has shipped in millions of iPhones since 2008, Apple recently revealed that it has dumped Skyhook for its own location technology. "Entrepreneurs are taught to pick something important to focus on," says Morgan. "But maybe we chose something too important." —*Peter Burrows*

The bottom line *Skyhook's lawsuit accuses Google of strong-arming smartphone manufacturers to keep them from using its location software.*

Hardware

HP's New Tablet Could Turn into a Spoiler

▶ Hewlett-Packard is bundling a tablet with a $399 printer

▶ "It's like showing up to the first date with an engagement ring"



The detachable display doubles as a tablet

Five months after **Apple** kicked off the tablet era with the iPad, **Hewlett-Packard** is trying to shake up the market by giving its tablet away free. Well, not completely free. The 7-inch tablet, measured diagonally, comes packaged with HP's $399 Photosmart eStation and serves as the printer's control screen. Equipped with Wi-Fi, it can be detached and used to download e-books from **Barnes & Noble**, play digital music, and connect to social media sites such as **Facebook**.

HP's tablet may look like a bargain next to rival products due out soon from **Samsung** and **HTC**. Those tablets are expected to be priced at around $400 with wireless carrier subsidies and don't come with a printer that can fax and scan documents, too. Some analysts think HP's move could cool other manufacturers' ardor for tablets. "It's a little like someone showing up to the first date with an engagement ring," says Roger Kay, president of technology consulting firm Endpoint Technologies Associates.

HP can afford to undercut rivals on price. Last year's version of the same printer had a built-in display and also went for $399. The company's Imaging and Printing Group makes money not on equipment but on cartridges of toner and ink. (Research firm Gartner crunched the numbers six years ago and

Pest Control

How to Keep the Bedbugs from Biting

Until it was banned in 1972, the pesticide DDT helped keep bedbugs in check. Increased international travel and other modern phenomena have contributed to a resurgence of the apple-seed-size insects, which feed on human blood. Outbreaks have hit several U.S. cities. In New York, stores including Niketown and Victoria's Secret have closed temporarily because of infestations. The pests are now attracting attention from scientists and entrepreneurs. On Sept. 21 and 22, the experts showed off their anti-insect weapons at the first-ever North American BedBug Summit in Chicago. —*Leslie Patton*



The Bed Moat

$18.99 for a four-pack

The moats sit beneath furniture and trap bedbugs as they try to climb up or down the legs. Insects remain alive after being caught and must be discarded. The Bed Moat's inventors suggest coating the trap with cornstarch, which dehydrates and immobilizes the pests.



Heat Assault 500X

$1,500 per eight-hour treatment

The 6,000-pound Heat Assault is a towable heating unit. It warms up propylene glycol, a colorless, odorless liquid. Once vaporized, the gas is pumped inside an infested building. The 120F, sauna-like heat kills bedbugs within a few hours by cracking their exoskeletons.



Cryonite

$400-$800 per two-hour treatment

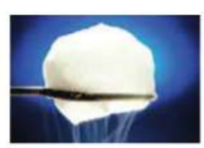
Cryonite is frozen CO_2, which flash-freezes bedbugs and kills them almost instantly. A device that looks like a cross between a fire extinguisher and a vacuum cleaner disperses the cryonite. A bendable hose makes it easy to get underneath furniture and other hard-to-reach places.



Protect-A-Bed

$130 for a queen-size cover

The Protect-a-Bed snugly covers a bedbug-infested mattress, locking the bloodsuckers within its bite-proof enclosure. The mattress can continue to be used while the bedbugs starve to death, a slow process that can take up to a year.



Dry Ice

Less than $20

For a do-it-yourself bedbug trap, wrap the outside of a dog food bowl with fabric. Turn it upside down, put talc inside the rim, and put dry ice on top of the contraption. Dry ice is made of the same molecule as human exhalation—carbon dioxide. That lures the bugs, which crawl up the fabric, over the rim, and get stuck in the talc.



Sergeant Jack Bauer

$350 per visit

Jack Bauer—named after Kiefer Sutherland's character on the TV show *24*—is one of three dog sleuths at Detective Bed Bug in Chicago. The dogs have been trained to sniff out bedbugs and can search a two-bedroom apartment in about five minutes. Their work can confirm an infestation and help exterminators better target their efforts.

DRY ICE: CHARLES D. WINTERS/PHOTO RESEARCHERS; ALL BED BUGS: PHOTO RESEARCHERS; DE HEER: PHOTOGRAPH BY MALI AZIMA FOR BLOOMBERG BUSINESSWEEK

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figured HP was charging the equivalent of $7,500 per gallon for ink.) The operating margin in HP's printing business was 17 percent in the last quarter, compared with 5 percent in the PC group. Vyomesh Joshi, who runs HP's printing unit, says the goal isn't so much to trounce the competition as to get people to print content off the Web. "There's a content explosion going on," he says, "and we absolutely want to get that content and print anywhere, any time."

The market for tablets is expected to grow from virtually nothing last year to 11 million units in 2010, according to forecasts from ABI Research. One potential concern for HP and other PC makers, though, is that consumers may come to see the tablets as replacements for laptops and desktops rather than as second or third computers. In a recent statement posted on the company's website, **Best Buy** CEO Brian Dunn noted consumers are shifting toward iPad-like devices. Says Richard Shim, research director for IDC's personal computing program: "Everyone is trying to figure out the opportunity for these types of devices, how to position media tablets in a way that they don't cannibalize other businesses."

17%

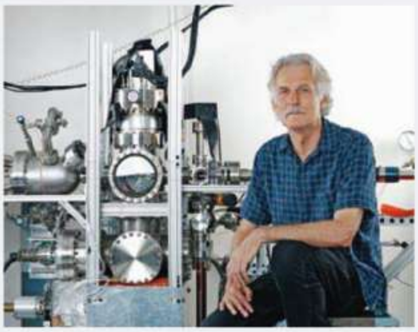
HP's operating margin in printers, compared with 5% in PCs

The eStation's tablet has limitations, which may convince consumers that this tablet is no PC substitute. For example, it does not offer full access to Android Market, the **Google** online store that carries more than 70,000 applications. Unlike the iPad's 10-hour battery, HP's tablet runs for only four hours before needing a recharge. That may be good enough for people looking to step up from **Amazon.com**'s Kindle, the electronic book reader that uses **E Ink**'s black-and-white technology, to a relatively stylish color screen and entertainment device. "It ain't no iPad, and it's not necessarily obvious that a tablet belongs with a printer," says Endpoint's Kay. "But for that price, I'd certainly be willing to take a look." Ⓑ —*By Cliff Edwards and Aaron Ricadela*

***The bottom line** HP's decision to bundle a tablet computer with its new $399 printer could make trouble for competitors.*

Innovator

Walt de Heer



Smaller, power-hungry processors push the limits of silicon. Physicist Walt de Heer thinks nanotechnology can provide a solution

As silicon transistors get smaller, with billions now crammed onto a single microprocessor, the chips get less efficient. They run hotter and require more energy to keep cool. For the ever more powerful smartphones and speed-craving servers of tomorrow, silicon is reaching its physical limits. Chip designers may need to find a new substance.

Walt de Heer thinks he has it. In his nanotech lab at the Georgia Institute of Technology, the physicist has been experimenting with graphene, a sheet of carbon one atom thick. It can transmit electrons as much as 100 times faster than silicon. That translates into faster computers while generating less heat and requiring less power. Although graphene was discovered in the 1960s, it wasn't until 2001 that de Heer began tinkering with it as a possible replacement for silicon.

The challenge is mass-producing it. Previous researchers cut graphene sheets into narrow transistors, leaving frayed edges that disrupted the electron flow. In 2006, De Heer had an idea: Rather than cut the stuff, why not produce it in the exact shapes needed by the computer industry? De Heer starts with crystals of silicon carbide, a compound containing equal numbers of silicon and carbon atoms. He arranges the substance into the form of an H-shaped transistor and then heats it to 1,500C. Some silicon evaporates, leaving behind a perfectly shaped graphene transistor atop a thicker layer of silicon carbide. De Heer's findings will be published in the October issue of *Nature Nanotechnology*.

Chip manufacturers have provided de Heer with about $800,000 in funding since 2003. Mike Mayberry, director of components research at Intel, says it'll be 5 to 10 years before graphene can be used in large-scale production. "People aren't putting down a billion dollars to build a factory to manufacture it," says Mayberry. "But they might at some point."

De Heer, whose father worked in the oil industry, moved around a lot growing up. He was born in the Netherlands, lived in Saudi Arabia and Aruba, played bass in a rock band that toured the West Indies, and eventually settled at the University of California at Berkeley to pursue a PhD in physics.

He knows new findings often turn out to be letdowns. The 1992 discovery of carbon nanotubes, an unusually strong substance with high conductivity, generated excitement as a possible silicon successor. He saw that their irregular shape would make them hard to manipulate. "I was getting annoyed at the unbridled hype," he says. "It's just snake oil."

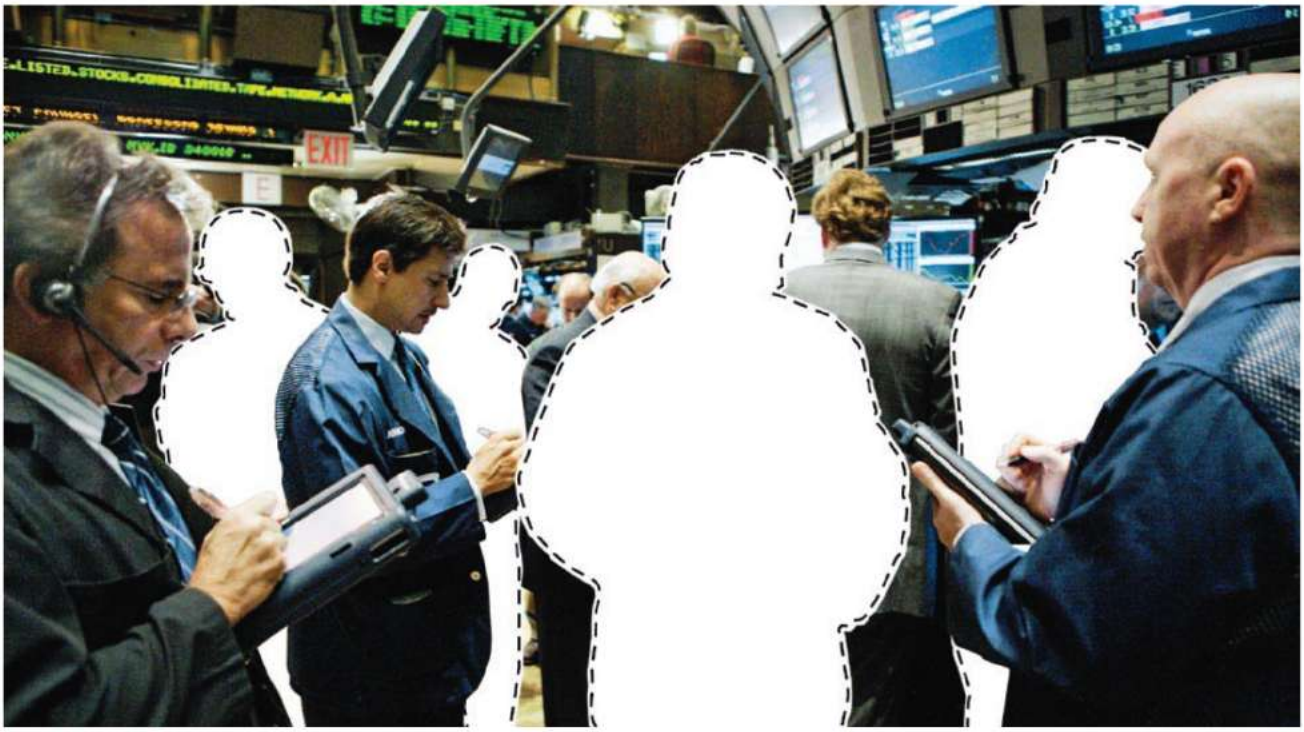
Even if graphene proves to be more promising than carbon nanotubes, silicon isn't going away anytime soon, de Heer says. While graphene might make sense for compact devices like cell phones or power hogs like server farms, silicon will be difficult to supplant. "Silicon is dirt cheap," he says. "Graphene can't make things cheaper, but it can go to much higher speeds and use much less energy." Ⓑ —*Oliver Staley*

Childhood ▶ Grew up in the Netherlands, Saudi Arabia, and Aruba

Insight ▶ A new process for building transistors out of graphene

Potential ▶ Tiny, powerful chips that don't require much energy

▶ Bankruptcy for a luxury travel club 44 ▶ A new role for a veteran Valley dealmaker 45 ▶ Britain's endless bank rescue 46 ▶ Commentary: Charlie Munger's uninhibited take on the bailout 47 ▶ Wall Street: Its stocks aren't popular, either 48 ▶ Bid & Ask 49



GINO DOMENICO/BLOOMBERG

Missing: The Stock Exchange Buyers of Last Resort

▶ Increased competition has lowered trading costs but removed a force for stability in the markets

▶ "In the move to electronic trading ... more technology and less of a role for humans"

The U.S. Securities and Exchange Commission spent the last 15 years trying to encourage more competition among stock exchanges. It succeeded. Trading that used to be concentrated on the **New York Stock Exchange** and **Nasdaq** today takes place on 11 exchanges. While this decentralized approach has lowered costs for investors, it virtually eliminated the traditional market makers who were obliged to buy and sell stocks when no one else would. Now the SEC is concerned the revolution went too far, leaving markets vulnerable when selling starts to snowball.

Chairman Mary Schapiro called on the agency in early September to examine whether the loss of "old specialist obligations" has hurt investors. With market making on most exchanges dominated by computerized trading firms that have few rules for when they must buy and sell, she said the SEC will consider ways to keep them from abandoning the market at the first sign of trouble. "In the old days, the specialist obligation was quite stringent," says Patrick Healy, a former trading executive at Bear Stearns who runs Chevy Chase (Md.)-based Issuer Advisory Group. "If he didn't meet it, he got canned. ... In the move to electronic trading, NYSE and Nasdaq emphasized speed, more technology, and less of a role for humans." John Heine, a spokesman for the SEC, declined to comment.

The debate over volatility gained urgency after May 6, when a sudden drop erased $862 billion in value in 20 minutes before the market recovered. Lawmakers have asked if the high-frequency-trading firms that have supplanted market makers destabilized the system by stepping away when they were needed most. "The players in our markets have changed, but our regulations have not kept pace," Senator Charles E. Schumer (D-N.Y.) wrote in a letter to Schapiro last month. "High-frequency traders pulled out during the free fall, leaving a dearth of liquidity and exacerbating market volatility." A report on the causes of the May 6 plunge from the SEC and the Commodity Futures Trading Commission is expected soon.

Vanguard Group, the biggest U.S. manager of stock and bond mutual funds, told the SEC in April that regulatory changes and pricing efficiencies produced by high-frequency-trading firms reduced costs for long-term investors by about half a percentage point over the past decade. A mutual fund returning 9 percent annually whose entire stockholdings ➜

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are sold and replaced within a year would see the gain cut to 8 percent without the savings, according to Vanguard, which oversees about $1.4 trillion.

Exchanges historically relied on specialists, or securities professionals who made markets in designated stocks and provided prices through their willingness to buy and sell shares. Specialists who stood amid traders on the NYSE floor were charged with maintaining "fair and orderly" markets by stepping in when buyers and sellers weren't available. Nasdaq market makers performed similar roles over phones and computers, with as many as several dozen handling action in any given stock.

Specialists and market makers got something in return for serving as buyers of last resort: the ability to see supply and demand for stocks and profit from the difference between the bid and offer prices, typically 6.25¢ on actively traded stocks in the late 1990s. They suffered when exchanges started pricing stocks in 1¢ increments in 2001, squeezing profit out of the bid-ask spread.

In October 2008 the NYSE, which had lost market share to other exchanges, overhauled its rules to compete more effectively. To allow specialists to provide better prices for investors, it lifted some trading restrictions and reduced their responsibilities. While the specialists, now called designated market makers, retained heftier obligations than market makers at most other venues, they didn't have to be the traders of last resort when the market turned volatile. They also lost some benefits: They no longer got a look at all orders, which had helped them gauge supply and demand in their stocks.

Nasdaq gradually eroded the market makers' obligations as the spread between bid and ask prices decreased. In 2007 it eliminated the 20-year-old requirement that market makers provide quotes that are "reasonably related" to the prevailing price. The thinking was that electronic trading firms pursuing different strategies would end up providing bid and offer prices for stocks through changing market conditions.

The SEC is in the "early stages of thinking about whether obligations on market makers akin to what used to exist might make sense," Schapiro told reporters on Sept. 7. The issue is "whether the firms that effectively act as market makers during normal times should have any obligation to support the market in reasonable ways in tough times," she said during a speech that day to the Economic Club of New York. The commission has introduced circuit breakers that pause trading in more than 1,300 securities if their price moves 10 percent in five minutes. One goal is to slow down trading when prices gyrate so investors can assess their reasons for buying and selling. It is also banning market makers from submitting quotes at unrealistically low prices, such as 1¢, so prices won't plunge when buyers temporarily disappear.

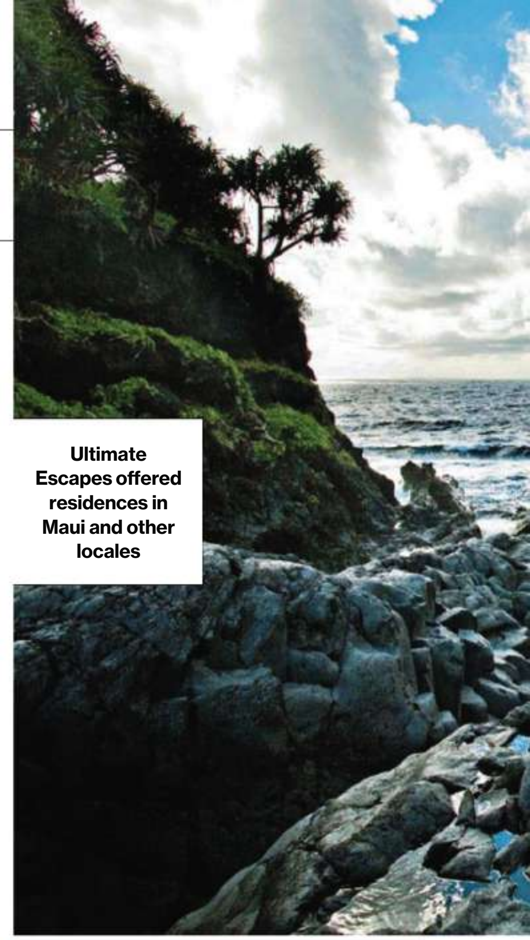
The old system wasn't flawless. The Brady Commission Report on the October 1987 crash, when the Dow Jones industrial average fell 23 percent, found NYSE specialists and Nasdaq market makers didn't stem the downward slide of prices. Many Nasdaq market makers didn't answer their phones, ignoring customers, while overwhelmed NYSE specialists who had bought as sell orders flooded in later gave up or halted trading. It's not clear that any specialists or market makers can withstand a tsunami of selling. William O'Brien, chief executive officer of exchange operator Direct Edge, says once a rout has started, no trader will obey a regulation that forces him out of business. "If you burden any firm–I don't care how big or fast your computers are–if you have to buy when everyone is selling until you're bankrupt, even the biggest, fastest trading firm is not going to want to take on that obligation." —*Nina Mehta*

The bottom line *While increased competition in stock trading has lowered costs, it may have made the markets more vulnerable to rapid price moves.*

Quoted

"This sense of somehow me beating up on Wall Street—I think most folks on Main Street feel like they got beat up on. ... There's a big chunk of the country that thinks that I have been too soft on Wall Street."
—President Obama speaking at a televised town hall meeting





Ultimate Escapes offered residences in Maui and other locales

Bankruptcies

End of the Line for A Luxury Travel Club

▶ Ultimate Escapes falls victim to the sluggish economy

▶ "If the developer gets into trouble, there's no recourse" for members

Ultimate Escapes, whose 1,200 members paid at least $70,000 apiece for pampered holidays in villas and yachts from Tuscany to Costa Rica, is taking a trip to bankruptcy court. "Let me start off with the bad news," Chief Executive Officer Jim Tousignant, 49, began a Sept. 9 letter to members. The six-year-old club, he continued, was in default on a $90 million loan and "increasingly likely" to seek bankruptcy protection. On Sept. 20 it went into Chapter 11 with debts of $100 million to $500 million, becoming the latest casualty in the destination travel industry.

In an interview before the filing, Tousignant blamed the 2008 financial crisis for the fiscal woes. Ultimate Escapes raised $15 million from a special assessment on members in January 2009. In October 2009 it went public, hoping to sell $30 million in stock, but raised only $10 million. "When your

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cash stops flowing, your expenses don't stop," Tousignant said in the interview. "You've got staff, you've got properties, you've got fees, property taxes, mortgages that have got to be paid."

Destination clubs such as Kissimmee (Fla.)-based Ultimate Escapes and Denver-based **Exclusive Resorts** (partly owned by America Online co-founder Steve Case) offer luxury vacations, complete with in-house concierges and on-call maids, as a more luxurious and exclusive alternative to a time-share or second home. "Upon entering your log home, you will be welcomed by the rustic mountain decor," reads a description of an Ultimate Escapes four-bedroom house in Stowe, Vt. "You or your Private Chef will love the Viking stove, complete with six burners and two ovens, and Sub-Zero refrigerator for creating dining masterpieces."

Tousignant says he started the club after surviving the September 11 attacks on the World Trade Center, where he was attending a breakfast meeting. He previously co-founded and sold Multex, an investment research firm. A basic membership in the club required a $70,000 one-time payment, plus $8,000 annual dues for a minimum of 14 days of access to $1 million residences. Prices could climb exponentially for longer breaks at more expensive properties. A "Platinum PLUS" membership in Ultimate Escape's Elite Club cost $450,000, according to the club's website.

Sales at such clubs flourished during the boom, rising to a peak of $610 million in 2007 from $450 million in 2004, according to Ragatz Associates, a resort real estate consultant. Collecting mansions around the world left some clubs with too much debt and too few fee-paying members after the bust. High Country Club, Solstice, and the Lusso Collection went bankrupt before Ultimate Escapes. The industry's sales tumbled to $195 million last year, Ragatz says. Some clubs, including the biggest membership-only group, Exclusive, are growing, says Levi Moe, founder of *Destination Club News,* an industry newsletter.

Members of bankrupt clubs may have trouble getting their money back. Many, including Ultimate Escapes, are structured so members don't actually own interests in the club's properties. "They get treated like kings, but if the developer gets into trouble there's no recourse," says Howard C. Nusbaum, president of the American Resort Development Assn. "If the club goes bankrupt, members have to get in line like any other unsecured creditor."
—*Beth Jinks and Jonathan Keehner*

The bottom line *The destination club industry, a luxury product of the financial boom, is finding it hard to survive in leaner times.*

Investment Banking

Thom Weisel Wants to Play Another Round

▶ The veteran tech dealmaker has a new firm with a familiar mission

▶ "We have foot soldiers out in the field talking" to companies

Thomas W. Weisel has spent four decades as a Silicon Valley dealmaker. Now he's betting that his connections and experience can help him build the Midwestern investment bank **Stifel Financial** into a bigger force in technology acquisitions and initial public offerings.

Weisel, 69, took the role of Stifel's co-chairman last month after the company bought his old firm, **Thomas Weisel Partners Group**, for almost $200 million. Stifel helps customers issue stock, raise debt, and buy and sell companies. It also owns brokerage Stifel Nicolaus. Weisel's challenge is to build Stifel's profile among Bay Area venture capitalists, private equity managers, and executives, many of whom haven't worked with the St. Louis-based bank. While mergers have picked up, some companies prefer to use the biggest investment banks, such as **Goldman Sachs** and **Morgan Stanley**. Weisel also faces a drought of IPOs.

"I've been doing this for 40 years," he says in an interview in his 37th-floor office in San Francisco. "We can have a strategic conversation that any CEO or any board wants to have. We have foot soldiers out in the field talking to both small companies and the big ones."



Weisel hopes his reputation will help win business for Stifel Financial

Weisel has been a force in the Valley since at least 1971, when he added his name to the firm that became Robertson, Colman, Siebel & Weisel. In 1978, Weisel took half the San Francisco company and renamed it Montgomery Securities, which helped shepherd dot-com IPOs, including **Yahoo!**'s 1996 offering. Montgomery, along with Alex. Brown & Sons, Hambrecht & Quist, and Robertson Stephens, made up "the four



U.S. towns take on Bangalore page 51 ▶

horsemen" of West Coast technology, as Robertson Stephens founder Sandy Robertson called them. Eventually, all four were bought by commercial banks.

Weisel sold Montgomery Securities in 1997 to what would become **Bank of America**. A year later he founded Thomas Weisel Partners. Stifel, founded in St. Louis in 1890, has catered to financial-services, industrial, aerospace, and education markets. "We can't be the kind of firm we want to be without being in tech, consumer, and health care," Stifel Chief Executive Officer Ronald J. Kruszewski told analysts in April, explaining the reasons behind his acquisition of Weisel's firm. "It expands us into these key growth sectors of the global economy."

In trying to win more mergers-and-acquisitions business, Stifel will be competing against some prominent advisory boutiques, including San Francisco-based **Qatalyst Partners** and two New York firms, **Moelis & Co.** and **Lazard**. Qatalyst CEO Frank Quattrone advised 3Par in its acquisition by **Hewlett-Packard**. Even with deals by Thomas Weisel Partners, Stifel would rank 30th this year among advisers in the technology, health-care, and consumer industries, according to data compiled by Bloomberg.

Weisel grew up in Milwaukee, graduated from Stanford University, and got his MBA from Harvard Business School. His office, decorated with modern art, skiing memorabilia, and Tour de France jerseys, is a showcase of his outside interests. He has supported the San Francisco Museum of Modern Art, the U.S. Ski and Snowboard Team Foundation, and Lance Armstrong's racing team. And he is an athlete himself: He tried out for the Olympic speed skating team in 1959 and competed in skiing and cycling events for decades.

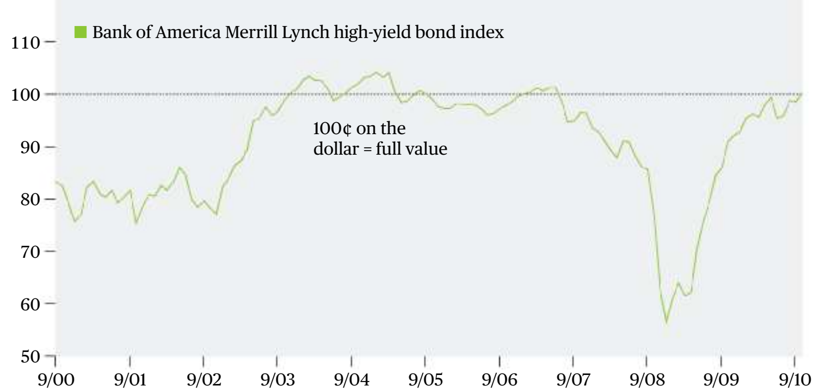
Robert K. Weiler, the former CEO of Phase Forward, tapped Weisel to help sell his company. **Oracle** agreed to pay $685 million for the Waltham (Mass.)-based business in April. "I met him in 2002, when I first joined Phase Forward as CEO, and he visited us as an emerging company," Weiler says. "He came in and said, 'Let me tell you about your industry.' He knew about our space, our competitors, and the challenges we face." Now, Weisel is counting on transferring that reputation to Stifel: "I'd like, over the next 5 or 10 years, to have Stifel inherit all of the goodwill we've built. That's the motivating factor." —*Dakin Campbell*

The bottom line *Thomas Weisel, long a force in Silicon Valley, hopes his connections will help win business for his new firm.*

Credit Markets

Junk-Bond Investors Bet They'll Be Repaid

Average prices on high-yield U.S. corporate debt rose above 100¢ on the dollar on Sept. 16 for the first time since June 2007. That means investors are betting they'll be fully repaid, dismissing concerns that the economy will go back into recession and trigger a rise in defaults. —*John Detrixhe*



DATA: BANK OF AMERICA MERRILL LYNCH

Bailouts

No End in Sight for Britain's Bank Rescue

▶ The government still holds big stakes in RBS and Lloyds

▶ "The markets are not favorable at the moment"

The U.K. committed more money to rescuing banks during the credit crunch than on any project in British history outside of world wars. The cost keeps rising as the government continues to pay interest on money borrowed to fund bank takeovers.

Oct. 7 marks the second anniversary of the bailout, which was spurred by the concern of then-Chancellor of the Exchequer Alistair Darling that **Royal Bank of Scotland**, the nation's second-largest bank, and **HBOS**, Britain's biggest mortgage lender, didn't have enough money to open their doors the next day. The government invested, lent, and pledged more than £850 billion ($1.33 trillion) to rescue stricken banks during the financial crisis that began in 2007, the National Audit Office, Britain's public spending watchdog, said in a December report. The government took an 83 percent stake in RBS, paying £45.5 billion, and agreed to insure £280 billion of its riskiest assets for an annual fee. It injected £20 billion into **Lloyds Banking Group**, which acquired HBOS, in exchange for a 41 percent stake. The U.K. provided an additional £450 billion in guarantees to increase bank liquidity.

While U.S., French, and Swiss banks have repaid their bailouts, Britain hasn't received any return on its investments in RBS and Lloyds, the country's third-largest lender. The annual interest payment on the bonds the government sold to pay for the rescue is about £3.2 billion, according to a JPMorgan Chase estimate, adding to the cost of the bailout.

Struggling to trim a budget deficit, British officials would like to sell the nation's shares in the two banks, but the timing of any sale is complicated. For one thing, a government commission is studying whether to have all the country's banks separate

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Alice Schroeder

Charlie Munger's Skewed Sense of Justice



Warren Buffett's partner is right about the bank bailout. A billionaire has to be careful, though, about telling the masses to "suck it up"

You've gotta love a man who speaks his mind, even when he's wrong. We "shouldn't be bitching about a little bailout" of the banks, Charles Munger, Berkshire Hathaway vice-chairman and Warren Buffett's closest confidante, told students at the University of Michigan on Sept. 14. That's a strong statement, but Munger is one of the refreshing few who can be counted on to deliver his thoughts uncensored in words unminced.

Munger says the bank bailouts were "required to save your civilization." He suggested that burdening the economy with bank failures would have results similar to the economic collapse in Germany after World War I that led to the rise of Adolf Hitler. Meanwhile, "the culture dies" if you bail out individuals. People in economic distress should "suck it up and cope."

Apart from what some might consider his tasteless hyperbole, the problem is the false dichotomy it presents. The choice wasn't between the bailout or no bailout. It was between the bailout we financed, which didn't resemble capitalism in any known form, and a bailout more intelligently executed.

No one made us bail out shareholders along with the banks' bondholders. We didn't have to preserve institutions that are still too big to fail in any meaningful sense of the term. We could have propped them up temporarily, then recapitalized them as smaller, more manageable entities, with former equity holders assuming the cost of the risk they assumed.

We missed the chance to reduce systemic risk by comprehensively rewriting regulation for the financial-services industry. Instead of withdrawing government guarantees, we increased them. So there are plenty of reasons to complain about the bailouts.

To give him credit, I'm pretty sure if we gave Munger dictatorial power, he would have structured the bailouts more intelligently than what actually took place. In his remarks he wasn't defending the form of the bailouts, only their size. If anything, "it should have been bigger," he said. His reference to a massive bailout needed to ward off another Germany-style hyperinflation also wasn't necessarily hyperbolic. It echoed his partner, Berkshire CEO Buffett, whose ongoing theme is that we've experienced an "economic Pearl Harbor." Both men look at the situation as oddsmakers. By their logic, if the damage from too much stimulus is tolerable and the damage from too little stimulus is intolerable, the expected value of the outcomes reveals that we should run the lesser risk of overstimulating. This is throwing people off the lifeboat to keep it from sinking.

Money Talks

Munger's financial interests line up with his words. Berkshire has large holdings in Wells Fargo ($8.5 billion), the U.S.'s biggest home lender, as well as a $5 billion investment in Goldman Sachs Group. If that's not a coincidence, it's probably because he puts his money where his mouth is rather than the other way around. In choosing sides between the opposing interests that inevitably arise in commerce, Munger and Buffett identify with the lender, not the borrower; with the bank, not the depositor; and that's how they invest.

It's not surprising, then, that Munger focused on the vital role banks play in society when he said people should suck it up and cope. Maintaining the trust that binds creditors and debtors is essential to the security of a culture.

What's unfortunate about this concern about bad incentives is that Munger didn't extend it to qualify his support for the bank bailouts and the tremendous moral hazard they created. It may seem appropriate to reward the thrifty savers by securing their deposits while leaving feckless borrowers to fend for themselves, until you consider that the banks were the worst abettors of the feckless borrowers.

As for trust, financial institutions have so much leverage with their customers these days that the relationship is rarely based on reciprocal values. It's inappropriate that the requirement of trustworthiness should run in only one direction, in favor of the bank.

Munger's prescription for the foreclosed masses suggests the result would be a form of justice that does us all a favor. Bailing out homeowners would be "shoveling out money to people who say 'My life is a little harder than it used to be,'" Munger said.

I'm all for self-reliance, and this perspective on misfortune deserves some latitude, coming as it does from a man who was raised during the Great Depression. Munger should be applauded for saying what he thinks without fear of being thought politically incorrect. In the end, though, coming from a billionaire, "suck it up" veers a bit too close to "let them eat cake." B

their retail and investment banking businesses, and no sale is likely until the commission's work is done next September because the findings may affect the value of the banks, according to government officials who declined to be identified.

Selling now also would leave the government with little or no gain on its investments. RBS and Lloyds have been among the best-performing bank stocks in Europe and the U.S. this year after returning to profit earlier than analysts expected. As of Sept. 17 the U.K. had a £3.35 billion paper profit on its stake in London-based Lloyds, after the shares gained 49 percent this year, and a £1.87 billion loss on RBS, even after its shares rose 64 percent. Since the start of the financial crisis in August 2007, RBS stock has plunged 90 percent, and Lloyds shares have fallen 73 percent.

"The government investigation into separating the banks rules out any sale in the short term," says Jeremy Scott, the global financial-services chairman of PricewaterhouseCoopers, who wrote a report saying it may take up to seven years to sell the stakes. "The markets are not favorable at the moment, even if you wanted a sale."

British officials also would like to sell Northern Rock, which it took over in February 2008. The government is managing the mortgage loans of another bank, **Bradford & Bingley**, after its branches and deposits were sold to Spain's **Banco Santander** in 2008.

U.K. Financial Investments (UKFI), which manages the country's bank holdings, declined to comment on how much the bailout would cost or when share sales might begin. The government announced in June that it is planning a discount sale of bank shares to the public to foster what Prime Minister David Cameron termed "popular capitalism." It is also considering selling shares to institutional investors and using convertible bonds to dispose of the stakes, UKFI said in its annual report last year.

While Britain's decision to take direct stakes in banks exposes taxpayers to risk, the government stands to benefit from the rise in share prices if it is patient, according to Charles Davis, an economist at the Centre for Economics and Business Research in London. "Holding the banks for longer gives the government a better chance of reaping bigger profits," says Davis, whose firm estimates that British taxpayers stand to make about £19 billion from the rescue. "Banks are getting their balance sheets in order and should become increasingly profitable over the next few years."

—Andrew MacAskill and Jon Menon

The bottom line *By holding its shares in RBS and Lloyds, the U.K. may earn a profit. Meanwhile, the cost of carrying the stakes continues to rise.*

1.5

TRILLION DOLLARS

U.S. household wealth lost in the second quarter, the first decline since March 2009. The total fell to $53.5 trillion from $55 trillion in the first quarter.

DATA: FEDERAL RESERVE

The U.K. Bank Rescue

The British government took big stakes in Royal Bank of Scotland (left) and Lloyds.



83%



41%

Financial Industry

Investors Remain Wary Of Wall Street Stocks

▶ **In the aftermath of the Lehman collapse, doubts about the model**

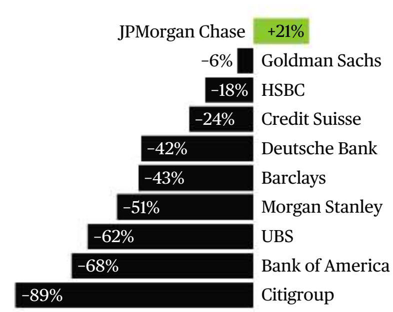
▶ **"Every aspect of the business has been damaged"**

Goldman Sachs Group was one of the best-performing financial shares in the past decade, beating the Standard & Poor's 500-stock index. That helps to explain Chief Executive Officer Lloyd C. Blankfein's $125 million in cash bonuses during the period. Now consider this: One-year certificates of deposit earned an average rate of 3.17 percent over the last 10 years, beating the 2.78 percent annual total return on Goldman Sachs. Buying a 10-year Treasury note in mid-September 2000 would have yielded a return of 5.8 percent annually.

Many investors may be skeptical of financial shares for some time. In the aftermath of the collapse of Lehman Brothers Holdings and the devastating economic slump that ensued, investors are questioning whether the investment-banking model that fueled record profits in the middle of the decade can be repaired. "The fundamentals of their businesses aren't going to be anywhere near as good as they were pre-Lehman," says Jon Fisher, a portfolio manager at **Fifth Third Asset Management** in Minneapolis, which handles more than

For Most Banks, Earnings Slide

Change in earnings per share from 2006 to 2011. Estimates for 2011 are as of Sept. 21.



DATA: BLOOMBERG

BANKS: BLOOMBERG (2); BID & ASK: CHRISTIES IMAGES LTD. 2010; GETTY IMAGES (4)

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$18 billion. "Every aspect of the business has been damaged."

Of 10 banks with large capital-markets business units, only Goldman and **JPMorgan Chase** are trading close to their prices on Sept. 12, 2008, the last day of trading before Lehman filed for bankruptcy. **Citigroup** has lost 78 percent, and **Bank of America** is down 60 percent. The average is a 25 percent decline, almost triple the 8.9 percent drop in the S&P 500 over the same period.

The earnings outlook for Wall Street banks remains pallid compared with profits in 2006, the year before the credit crisis began. Estimates for 2011 earnings per share are lower than 2006 for all except JPMorgan, according to data compiled by Bloomberg. Citigroup's 2011 earnings-per-share forecast is 89 percent below 2006 earnings, while Bank of America and Zurich-based **UBS** will probably fall more than 60 percent below 2006 levels on a per-share basis.

The financial crisis led to new regulations that set limits on banks' activities and will require them to hold more capital and liquid assets. "The rules of the business have all been changed," says Peter Sorrentino, senior portfolio manager at **Huntington Asset Advisors** in Cincinnati, which manages $13.3 billion and has reduced its holdings in large-bank stocks. "We see more pitfalls than we do potential profits in that group, and then there are so many question marks with regard to financial-services regulation."

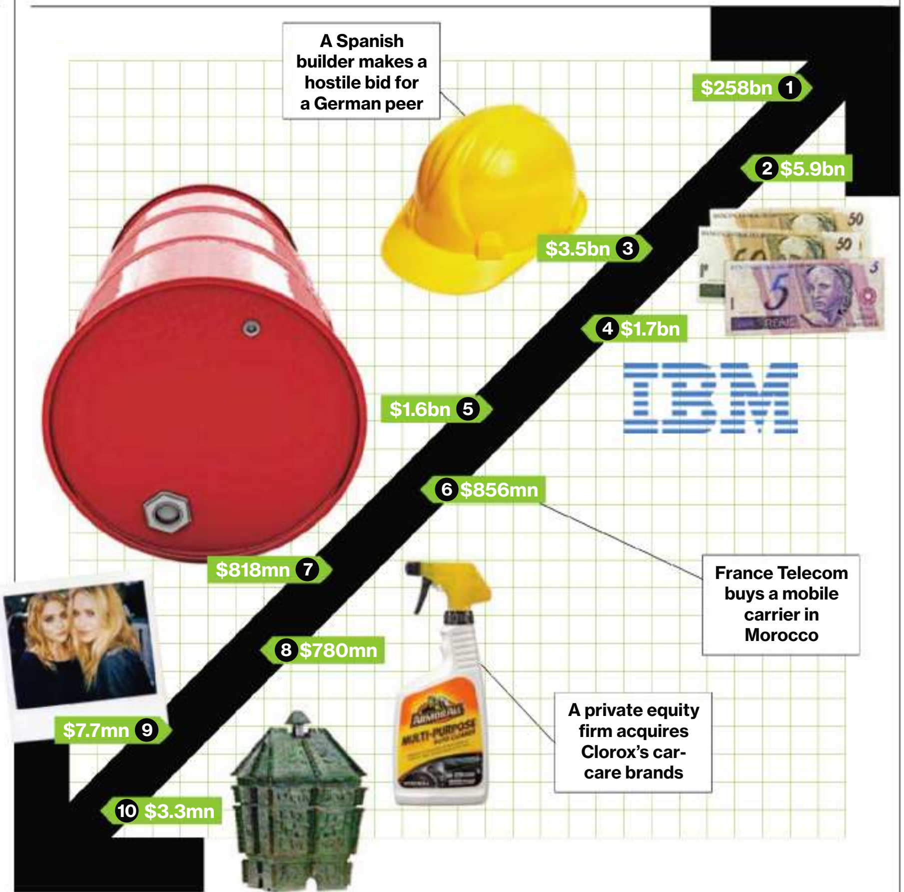
Investors may be shunning large-bank stocks because they haven't recovered from the shock of Lehman's implosion, says Michael K. Farr, president and founder of Washington-based **Farr, Miller & Washington**, which manages about $650 million. "Valuations look very low to me, and I think there's opportunity there, but I think there's also ample reason for the abundant caution that investors are showing," says Farr, who recently bought shares of Bank of America. After Lehman, he says, "we all began to see that as we looked behind the curtain, the guy pulling the levers was not in very good shape at all." B

—*Christine Harper*

The bottom line *The financial crisis changed investors' view of Wall Street banks as perpetual money-making machines.*

Bid & Ask

by Cristina Lindblad



1 **Microsoft, PepsiCo,** and **Hewlett-Packard** are among a host of U.S. companies taking advantage of record-low interest rates by borrowing money to buy their own shares. American companies have announced nearly $258 billion in buybacks this year, compared with $125 billion in all of 2009.

2 **Brazil's central bank** spent $5.9 billion in the first 12 business days of September buying dollars in an effort to fight appreciation of the real. Brazil's currency has gained 34 percent since the beginning of 2009 as investors have grown bullish about the country's economic prospects.

3 Spanish builder **Actividades de Construcción & Servicios** launched an unsolicited $3.5 billion offer for German developer Hochtief, in which it already owns a 30 percent stake.

4 **IBM** agreed to pay $1.7 billion for Netezza, a Massachusetts data warehouse company that counts NYSE Euronext among its clients. IBM CEO Sam Palmisano said in May that he plans to spend about $20 billion on acquisitions in the next five years.

5 **Safran**, a French maker of aerospace equipment, is paying $1.6 billion for a majority stake in L-1 Identity Solutions, a U.S. company that specializes in biometric technology.

6 **France Telecom** is buying a 40 percent stake in Moroccan mobile carrier Médi Telecom for $856 million. The French carrier is seeking to expand abroad to offset a sluggish market at home.

7 **McMoRan Exploration**, a partner in some of the largest U.S. offshore oil discoveries of the past decade, is paying $818 million for stakes in wells in the Gulf of Mexico.

8 **Clorox** is selling its Armor All and STP brands of car products to Avista Capital Partners for $780 million.

9 **The Olsen Twins** sold a penthouse in downtown New York for $7.7 million. The property, which had been on the market since 2005, once had an asking price of almost $12 million.

10 **Christie's** logged a record for an e-mailed bid: $3.3 million for a 12th century Chinese bronze.



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Cayuse's Benoist plans to hire 75 employees in 2011

'Rural Outsourcers' Vs. Bangalore

▶ A small-town alternative to offshoring info tech services work is booming

▶ "We cost less than the East and West Coast, and we're easier to deal with than India"

These are fat times at **Cayuse Technologies.** The 200-employee tech outsourcing firm, owned by the Confederated Tribes of the Umatilla Indian Reservation in northeast Oregon, saw $7.7 million in sales last year, seven times what they had been in 2007, its first full year of operation. With revenues from corporate clients such as **Accenture** expected to exceed $11 million next year, Cayuse aims to hire an additional 75 workers, says Marc Benoist, the company's general manager. "We still have capacity here at our facility, so we have plenty of room for growth," he says.

Cayuse is one of a handful of fast-growing information technology companies in remote areas of the U.S. that are positioning themselves as alternatives to offshore outsourcing. On an hourly basis, these "rural outsourcers" cost anywhere from 10 percent to 150 percent more to use than rivals overseas. After factoring in additional costs such as oversight and quality control of the offshore work, however, rates are comparable, says Mary Lacity, a professor at the University of Missouri in St. Louis who studies outsourcing. And the rates of the rural outsourcers are better than their domestic counterparts in big cities because the towns and small cities where they operate have lower living costs. "Their value proposition is, 'We cost less than the East and West Coast, and we're easier to deal with than India,'" says Lacity.

There are about 20 such companies now, up from two 12 years ago, estimate industry executives. "A lot of it is being driven by dissatisfaction with India and challenges with visas," says John Beesley, director of business development at 100-employee **CrossUSA**. Other companies, including **Saturn Systems, Rural Sourcing**, and **Onshore Technology Services**, are reporting double- and triple-digit revenue growth in the past few years. Last year, IT research firm Gartner said in a report that while the companies make up a sliver of the market, they are an "attractive alternative" to offshore outsourcers because of language and other cultural benefits. It's also easier for them to comply with U.S. data privacy regulations, the report said.

Ascensus, a 1,000-employee company in Dresher, Pa., that

PHOTOGRAPH BY JOHN CLARK FOR BLOOMBERG BUSINESSWEEK

Facebook's advertising revolution page 64 ▶

makes retirement plan software, started using Duluth (Minn.)-based Saturn Systems three years ago. Ascensus spends about three-fourths of its $175,000 outsourcing budget for IT development on the 35-employee firm. Though Saturn costs about 2.5 times more than offshorers in Russia and India, it's worth the premium, says Rick Fitzer, vice-president for software development at Ascensus. "On the surface, offshore outsourcing may appear more cost-effective," he says. "However, there can be added costs to consider with regard to managing staffing, training, and geographic logistics."

Rural outsourcers won't replace the offshorers. India has outsourcing revenue of about $50 billion, and that's expected to triple by 2020, according to a 2009 report by Nasscom, India's software services trade group, and consultant McKinsey. No numbers exist for the size of the rural outsourcing market in the U.S.; Lacity estimates it's less than $100 million a year. She notes that interest has grown in the past two years as federal policymakers seek ways to create jobs and as government outsourcing contracts increasingly require work be done in the U.S.

The fledgling industry also could get a boost from economic pressures on offshorers. Workers pushing for higher wages in China and India might eventually make domestic startups more attractive, says Deborah M. Markley, managing director for the Rural Policy Research Institute's Center for Rural Entrepreneurship in Chapel Hill, N.C. "Is the cost structure going to shift so that it becomes cheaper to do things here in the U.S.? It's going to take a while before that happens," says Markley. "[But] there's a lot of potential behind [rural outsourcing in the U.S.]."

The challenge is training enough workers, says Shane Mayes, founder of 70-employee consulting firm Onshore Technology Services, which estimates it will have $10 million in revenues this year. "We take underemployed and dislocated workers who've lost manufacturing jobs and put them through a bootcamp-style training program," he says. "We make software developers out of them." With clients paying from the low $20s to $50 an hour, he says the firm has doubled its growth in recent years. Mayes has centers in Lebanon, Macon, and Joplin, Mo., and plans to hire 70 more employees in 2011.

Critics contend rural outsourcing will remain a niche because it won't be able to scale to a significant size for lack of workers. In a *Strategic Outsourcing* journal article, Lacity points out that more than 61 million people—a quarter of the U.S. population—is rural. Randy Willis, an Accenture senior executive who conceived of and hatched Cayuse Technologies, agrees the biggest challenge is creating and maintaining a large enough skilled workforce. "To meet the cost structure, you pretty much have to build the skills from scratch," he says. "The good news is we can supplement with lower-skilled work while we're growing the deeper skills."
—*Nick Leiber*

The bottom line *U.S. tech outsourcers in rural areas are competing with offshorers on convenience and with their domestic big-city rivals on price.*

44

The average age of business founders in the U.S. Over the past decade, people aged 55-64 created the most new businesses. The 20-34 age group created the fewest.

DATA: KAUFFMAN FOUNDATION

Intellectual Property

Patent Reform: High Stakes for Small Biz

▶ **A proposed fast-track review could benefit entrepreneurs**

▶ **"The most senseless system of delayed...examination imaginable"**

Ben Cappiello thinks he has a better way to make intrauterine contraceptive devices. He's hoping to patent his idea, but when his application gets to the U.S. Patent and Trademark Office in October, it will land at the bottom of a stack of more than 700,000 others. Cappiello can expect to wait nearly three years for a ruling, which could make it harder to raise money. Venture capitalists are wary when "there are still a lot of question marks about your intellectual property," he says.

The Patent Office concedes the system is broken and is proposing changes that would give applicants more control over the timing of the process. One shift would let applicants pay more to jump to the front of the queue, guaranteeing a decision within a year. "We are currently operating the most senseless system of delayed and delinquent examination imaginable," David Kappos, the patent agency's director, said at a public hearing on the proposal in July. He hopes to have the plan in place next summer. Congress will have

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to approve some of the changes.

The Patent Office says the fee for fast-track review would be "substantial," though it hasn't yet announced a price. The average patent application fee under the current system costs $1,000, Kappos says, though small businesses and individuals get a 50 percent discount. (That's not counting attorneys' fees of $10,000 or more.) Kappos says smaller companies could get a similar discount on the price of fast-track examinations.

Not all applicants want a speedy review. The new system also would give entrepreneurs the option to put off examination for up to 30 months. That would let companies avoid paying the full fee when they file to patent early-stage ideas that might never reach the market, because the bulk of the fees are due at the end of the process. (If a patent is granted, the protection is retroactive to the date of the filing.) Small businesses have expressed interest in both the fast-track option and the potential to delay review, says Kate Reichert, assistant chief counsel at the Small Business Administration Office of Advocacy. "If a small business has a patent and its business is going to be based on that patent," she says, "it would be very, very helpful to get that processed quickly."

—John Tozzi and Susan Decker

The bottom line *Letting patent applicants speed up or delay examinations could help small businesses if fees don't put the fast-track reviews out of reach.*



Shelstad left traditional publishing to start an online book service

PHOTOGRAPH BY ETHAN HILL FOR BLOOMBERG BUSINESSWEEK

Innovation

Online Startups Target College Book Costs

▶ New publishers offer inexpensive—or free—books online

▶ Education "is by far the biggest information industry"

When Dennis Passovoy, a lecturer at University of Texas' McCombs School of Business, selected a new textbook for his organizational behavior class last year, his students didn't even have to buy it. They could read the book online for free, or purchase it in several formats, including as an audio book, PDF, or $30 paperback version ordered online that would be printed and then shipped to their doors. "It was equally as good as this $160 textbook, but what really got my attention was if the students adopted the book online, it was free," says Passovoy, who got the new textbook from startup publisher **Flat World Knowledge**.

Flat World was launched in 2007 by two textbook industry veterans to provide an alternative to expensive course books, such as *Organizational Behavior*, a standard text from **Prentice Hall** that lists for $180. "It was so obvious to anybody in the industry that students are running as fast as they can to avoid buying a new book," says Jeff Shelstad, Flat World's 46-year-old chief executive officer. CourseSmart, a joint venture by major textbook publishers including **Pearson** and **McGraw-Hill**, distributes digital versions of textbooks for a fee. Six months of digital access to *Organizational Behavior*, for example, costs $98, according to the venture's website.

Flat World, a 32-employee Irvington (N.Y.) company, is among a wave of startups trying to change the economics of this corner of higher education. "In the last six months there's been

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a huge explosion in this area," says Vic Vuchic, program officer at the Hewlett Foundation's Open Educational Resources project, which supports efforts to offer learning materials online for free. He says at least two dozen companies now use technology to make learning more affordable and accessible, up from about a half-dozen two years ago.

These entrepreneurs want to use the innovations that have upended other media–e-readers, online video, and social networking–to transform the way people learn. Education "is by far the biggest information industry," says Jose Ferreira, a former executive at **Kaplan** who founded online test prep startup **Knewton** in 2008. Like Flat World, Knewton hopes to lower costs for students by moving traditional elements of classroom learning to the Internet. The New York company sells online test prep lectures with technology that tailors lessons to individual learning styles. More than 10,000 students have taken Knewton's classes, and Ferreira is talking to publishers and colleges about delivering textbooks and lessons via its technology.

The backlash against rising prices is giving a boost to the startups. Entering freshmen this year will pay 32 percent more for textbooks than the class of 2010 did four years ago, according to Bureau of Labor Statistics data. While Flat World makes no money from free versions, Shelstad says about half of students in classes that use the company's books make some type of purchase. (In classes using traditional textbooks, about 70 percent of students buy the book, he says.)

Colleges also increasingly offer course materials online. Richard Ludlow founded **Academic Earth** two years ago to aggregate videos of university courses. "Since we've started, more and more universities have added to the open courseware movement," says Ludlow, a 24-year-old Yale graduate. The site now offers 150 free courses and has 300,000 unique visitors monthly, more than half from outside the U.S.

Knewton and Flat World also hope to cater to growing demand abroad. Students in India, South Korea, and Malaysia are among the 70,000 who will use Flat World books this year, and a quarter of those taking Knewton's most popular test-prep program, the GMAT exam for graduate business schools, come from outside the U.S.

Education is "a massive global market undergoing a huge amount of change," says Bo Fishback, a vice-president for the nonprofit Kauffman Foundation, which promotes entrepreneurship. In July, Kauffman announced a program to foster 20 education startups with intensive assistance next year; more than 1,200 have applied. Fishback predicts more companies will seek to make education affordable because "the fundamental cost of what it takes to get a four-year degree is just growing and growing." *—John Tozzi*

The bottom line *Entrepreneurs want to use technology to change student behavior and make education more affordable and accessible.*

Quoted

"There's this issue in innovation circles: Why are so few women doing entrepreneurial things?... I think women typically have a little less time in childbearing years than men, and that diminishes participation in entrepreneurship."
—Robin Chase, CEO of GoLoco, former CEO of Zipcar, speaking to students at Worcester Polytechnic Institute



FROM TOP: ZIPCAR/BLOOMBERG; ALAMY; PHOTOGRAPH BY SALLY PETERSON FOR BLOOMBERG BUSINESSWEEK; DAVIES+STARR/GETTY IMAGES; ALAMY

Lending

Stranded Borrowers: Three Case Studies



While banks insist they're willing to make loans to creditworthy companies, lending to small businesses has dropped by $45 billion since 2008, according to filings with bank regulators. Here are stories of three small business owners who are struggling through the credit crunch.
—John Tozzi and Bob Ivry

Jaime Honold, 43
Burgers & Beer
El Centro, Calif.
Revenue: $16 million

A year ago, Jaime Honold (left) wanted to open a fifth Burgers & Beer restaurant. Sales at his 25-year-old chain, which operates in California and Arizona, have been flat or slightly down during the recession. Burgers & Beer is still profitable, Honold says, because it has trimmed expenses. Yet when he asked for a loan to raise the cash for the new outlet, his longtime bank told him to wait because of the uncertain economy, he says. "We want to expand but we can't. They told us it's not about your business. We know you're doing good," Honold says.



Russ Brackett, 61
Video Loft
Boothbay Harbor, Me.
Revenue: $1.2 million



Last December, a month after Russ Brackett opened his second store, he says a local bank froze his $50,000 credit line because regulators had warned the bank that it was undercapitalized. Six other banks turned Brackett down when he tried to replace the credit line and refinance another term loan he had with the same lender, he says. Though Brackett has been in business 26 years and was profitable in 2009, lenders told him he didn't have the collateral or cash flow to support a credit line. In July he got a $35,000 microloan from nonprofit lender CEI. "I'm certainly not the only one in this situation. There's hundreds and hundreds of us," says Brackett. "Unfortunately, a lot of them had to fold."

Dan Larson, 52
HydroSolutions of Duluth
Duluth, Minn.
Revenue: $950,000

HydroSolutions, which manufactures components for small jets and planes, has been unable to finance the metal and plastic it needs to fill new orders. Coming off the eight-employee company's dismal lows of 2009, sales have grown more than sixfold this year, Dan Larson says. He took $100,000 out of his retirement savings last year—paying a 10 percent penalty—to keep the company's doors open. Even though the business has recovered, he can't get a $50,000 line of credit. He says his bank is under pressure from examiners to increase liquidity. "I'm just stymied at this point and not able to add new equipment," says Larson.



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Speed Dial

The Case for Thinking Small

Consultant Greg Verdino says businesses can use social media to shift from targeting everyone to cultivating only customers they want

Entrepreneurs have been aiming for a select group of customers for years. What's new here?
The playing field has flip-flopped. Social media and the Web gave small business owners ways to compete more effectively against big businesses. But a lot of companies are struggling with the shift to a universe where everyone can be a mini media mogul.

Isn't it hard to tell if social media campaigns are working?
I don't believe it's more difficult to measure the impact. Think of any form of traditional advertising; there is no reliable way to say exactly what you got in many cases. Some of the social-media campaigns may be less predictable and harder to wrap your head around, because they involve more than just creating one ad and running it anyplace that will take your money. But social media is no less measurable. Ford, for example, knows the 10 million-plus impressions it got from its social-media campaign for the Ford Fiesta launch was far greater than it would have seen in a traditional campaign. The company got nearly 100,000 people to say they wanted to test-drive the car. And it had 60 percent brand awareness for a vehicle that wasn't even on the market—roughly equivalent to the awareness of a car that's been on the market for two to three years. That's a very tangible outcome for a far lower cost.

How do you persuade time-strapped managers to use social media?
I would challenge small business owners to identify one thing that's not working in their marketing. If they're investing time and energy in sales activities that aren't resulting in an acceptable close rate, they should reinvest that time in new approaches. A little less cold calling and a little more sharing thought leadership on a blog might have more people picking up the phone. The old ways of marketing aren't working as well as they once did. That doesn't mean I'm advocating a full 180. The two can work in tandem. Over time, many of these new approaches can come to overtake the old ways and be more effective for less money—even if in the interim it costs you a little bit of time.

Is this just for companies that sell to consumers?
Oftentimes, business-to-business gets short shrift when it comes to social media. But the very notion of "micromarketing"—using these tools and tactics to appeal directly and deeply to the few right people—is at least as well suited to business-to-business marketers. Most of these companies are, by definition, micromarketers. They appeal to a tightly focused, highly targeted community rather than the masses. Ⓑ
—Nick Leiber



Enterprise

Job Creation

A Drop in the Ranks Of the Self-Employed

▶ Unlike in earlier slumps, the jobless aren't launching companies

▶ "The failure rate of self-employment picked up a lot"

The number of self-employed Americans is at the lowest level in eight years, a sign that the economic recovery isn't yet strong enough to nurture new businesses. Some 8.68 million people worked for themselves in August, the fewest since January 2002, the Labor Dept. reports. That's down 13 percent from a record 9.98 million reached in December 2006, 12 months before the latest recession began.

Self-employment tends to increase during and immediately following economic slumps as tight labor markets prompt recently fired workers to venture out on their own. The data this time reflect the tight credit and falling demand choking small businesses, says Scott Shane, an economics professor at Case Western Reserve University in Cleveland. "The failure rate of self-employment picked up a lot during the recession," he says. "The indications are not good at all." Only when larger companies begin hiring well after a recession ends does self-employment usually start to wane, Shane says.

A broader measure of self-employment, which includes people whose businesses are incorporated, fell to 13.9 million in the second quarter, down 7.2 percent since the start of the recession and the lowest in eight years, according to Labor Dept. data. Gene Fairbrother, lead business consultant for the Grapevine (Tex.)-based National Association for the Self-Employed, says fortunes may be about to turn. Calls to the NASE's business hotline are starting to change from questions about financing to queries about how to help a business increase sales, he says: "That would be an indicator that for small businesses the economy seems to be stabilizing."
—Courtney Schlisserman

The bottom line *Self-employment typically increases after a recession. That's not happening this time, a sign that the recovery remains weak.*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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WHAT WOULD HAVE TAKEN FOUR WEEKS OF EMAILING TOOK FOUR HOURS FACE-TO-FACE.

-John and Erin O'Sullivan, Benchmark Clothing founders





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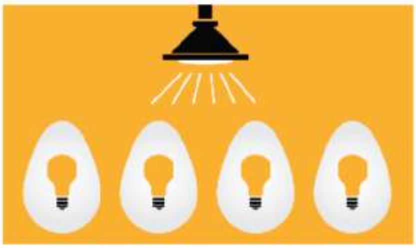
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Enterprise

Young Entrepreneurs

An Incubator Hatches Student Startups in Utah



▶ In the hands-on program, fledgling business owners learn from peers

▶ It provides "experiences that bridge theory and the real world"

While in college and working part-time at a specialty market in downtown Salt Lake City buying gourmet chocolates and olive oils, Nick Frappier lined up the contacts and funding to start his own specialty food importer. The 22-year-old fine arts major had been in business more than a year when he realized this spring that he lacked the first clue about how to run a company. "I might have had the groundwork laid, but I had no idea what I was doing," he says.

So when he got his degree in May, Frappier joined the inaugural class at the Foundry, the University of Utah's new business incubator. In one summer his company, **A Priori**, went from 12 clients to 40 and brought in $93,000 in sales, more than double what he'd made in the first 14 months of business. The college hopes the Foundry's blend of management training and peer mentoring will help hundreds of students turn their ideas into viable companies.

The Foundry, launched in May, has already seen 29 teams create 18 registered businesses that together have generated $220,000 in revenue. (Frappier's company accounts for more than one third.) Among the other successes are software startup **Novobi** and **Sundial Technologies**, which is developing a frozen gel-coated spoon used to cool hot liquids. Foundry businesses have already created 22 full-time, paying jobs, including those of 10 company founders.

The incubator is part of a year-old effort at the University of Utah's David Eccles School of Business to "reboot the entrepreneurship program" around practical experience, says Rob Wuebker, Frappier's entrepreneurship professor and the incubator's faculty adviser. During the summer, 66 students working on 29 ventures shared the 3,500-square-foot downtown office. The school's goal: Give young entrepreneurs a network to help their businesses succeed. "Having, say, 15 early-stage companies in one place, there'll be a lot of cross-fertilization of ideas," says Dinesh Patel, managing director of vSpring Capital, a $400 million venture capital firm

▶ For more stories and features from our annual report on top entrepreneurs age 25 and under, visit **businessweek.com/go/sb/25andunder**

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in Salt Lake City. "For a student that would be a huge advantage."

Eccles Dean Taylor Randall says students' interest in starting businesses has spiked because grads have a harder time finding work with the national unemployment rate at 9.6 percent. "If companies aren't going to hire students, we'll help [students] create the jobs," Randall says.

Demand for Wuebker's entrepreneurship classes on campus is so great that his room typically packs in double the 35 students on the official roster. Everyone who shows up has to work on a real business. In May he and Randall decided to turn a downtown space the university used for lectures and offices into a free small business boot camp to support the startups coming out of the class. "We focus almost all of our energy on resolving the one thing that makes most startups... fail: They can't manage their way out of a paper bag," Wuebker says.

The space, which the school leases for $5,000 a month, has fewer than 20 cubicles and half a dozen offices. The university provides the bare minimum: desks, chairs, meeting space, printers, Internet access, and whiteboards.

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Jobs created since May by businesses nurtured in the Foundry

Students arrive at the Foundry by 7:05 a.m. on Mondays for an executive meeting where they share problems and offer solutions. Every member has already read the other teams' progress reports from the previous week, due by 6 p.m. on Saturday. Students have 24-hour access, and there's often someone there tinkering in the wee hours. "If you run into a problem, more often than not your colleague is able to troubleshoot," says Patrick Duke-Rosati, 26, co-founder of the six-employee **RedFlower**, which manufactures the fruit drink Aguas Frescas. At the start of the summer, Duke-Rosati and co-founder Fidel Crespin walked into the Foundry with an idea, but no solid plan. Now RedFlower brings in thousands of dollars each week selling at farmers markets and is in the process of securing shelf space in a Utah retailer with six stores.

Beginning this fall, the university turned the incubator into a year-round program open to students and grads from any university. As the Foundry develops, Randall expects to offer more sophisticated resources such as workshops to build prototypes or kitchens for aspiring restaurateurs. The hands-on approach will remain the same, though. "We've tried to provide experiences that bridge theory and the real world," Randall says. "It's a good testing ground for entrepreneurs, and we're here to help them pass." **B**

—*Sommer Saadi and John Tozzi*

The bottom line *The University of Utah's small business incubator gives students support from peers to help them turn ideas into companies.*

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Divya Gugnani owns the culinary web company Behind the Burner; and for her, Booming is getting paid faster. After using social media to reach 140,000 subscribers in just two years, Divya needed her cash to flow as rapidly as her company was growing. So she started invoicing with AcceptPay,® a new online payment solution from American Express OPEN. Now her advertisers have more ways to pay, and she's getting paid around three weeks faster. Get your business Booming at open.com.

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COMCAST BUSINESS CLASS

LESSONS LEARNED

Lesson 5: Moving On Up: Real Estate Decision-Making

At some point, most small businesses' need for space will change. This is especially true of fast growth firms. Many move from a basement or home office to shared or commercial space. Later, companies often expand from plug-and-play offices to a full floor or building. And ventures with an established cash flow may even consider purchasing a building as an investment, as well as to hold its expanding team of employees. But when does a move or expansion make the most sense?



When Virtual No Longer Works

Since physical space needs often parallel sales and workforce growth, there may come a time when your virtual team finds it needs a central meeting place. That time came for Granite Consulting Group (www.consultgranite.com) two years ago, when the firm employed four consultants and subcontractors, says Managing Director Michael Bechara, CPA. Granite is a governance, risk and financial management consultancy based in Brewster, New York. Although the firm's employees work off-site 75% of the time, at client offices, the remainder of the time they need a quiet place to work that is always available. Telecommuting was no longer a viable way to work once the firm had four team members.

Balance Present and Future Needs

Dolcera (www.dolcera.com), a technology and patent research services company based in Redwood City, Calif., has a small staff in the U.S. and a quickly-expanding team in India. The challenge in Silicon Valley, says CEO Samir Raiyani, is finding a few hundred feet appropriate for a handful of people; few landlords want to carve up larger space. "So you either overpay for the space or you get dingy offices," he says. Dolcera, in their India offices, has signed three-year leases and then moved to larger digs after each term was up. Since it will soon outgrow its space once again, the company is weighing whether to move into larger, similar space; move into managed office space; or move into more expensive offices within a specialized economic zone, which yields tax breaks. Raiyani is currently weighing all three options.

Whenever possible, do not lock yourself into a ten-year, or even a five-year, lease if you are not fully confident in your projections.

Plan Shorter Term

Whenever possible, do not lock yourself into a ten-year, or even a five-year, lease if you are not fully confident in your projections. An annual lease is perhaps the best scenario, rather than committing to space that will likely no longer meet your needs in a matter of months. Conversely, do not look too far ahead or you may end up leasing space that is much too large at the moment, for which you will pay more than you need to. Starting out, use conservative projections to guide your employment outlook and your space needs. Then, "once your business model is solidified, work based on more optimistic projections," advises Raiyani.

To Buy or Not to Buy

Once your growth trajectory has leveled out, along with your workspace needs, purchasing space is an option. Evaluate the current real estate market to gauge whether you can buy an undervalued property that will serve your needs for at least 3-5 years, suggests Raiyani. But do not rush into such a large commitment. In the case of growing small businesses, flexibility is critical.

For more tips on running your small business and how Comcast Business Class can help, visit **www.business.comcast.com**.

Illustration: David Lesh

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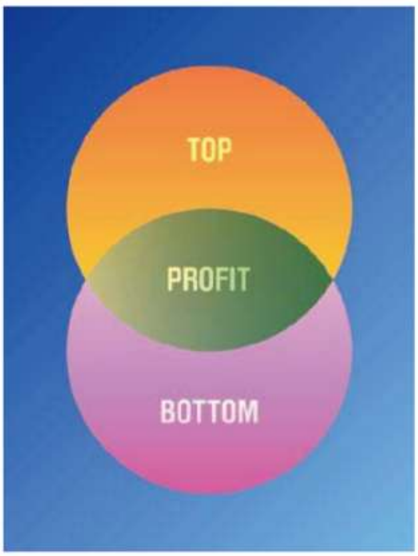
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Focus On Enterprise

Jody Heymann

Bootstrapping Profits By Opening the Books



Financial transparency and giving workers at all levels a direct stake in a company's success can help boost both efficiency and earnings

All 213 employees at Great Little Box know exactly how profitable the business is. Executives at the Canadian packaging manufacturer discuss the company's finances, production, and sales performance in detail at monthly meetings with staff that ranges from machine operators on the factory floor to senior managers. Such open-book management is tied to the company's profit-sharing strategy: 15 percent of pretax earnings are split equally among everyone at Great Little Box. The company started profit sharing in 1991 because they believed employees would work harder if they felt "they matter and their work matters," says Margaret Meggy, who co-founded the company with her husband and now serves as its human resources chief.

She's right. Our research shows that sharing financial information and profits with low-skilled workers helps boost both efficiency and profits. Yet while sharing profits and financial data with top managers is common, it is rare at the bottom of the corporate ladder. Only 1 percent of American companies use open-book finances, according to *CFO* magazine.

At Great Little Box, managers and factory workers alike say the openness motivates everyone to work harder because they want to increase the company's profits—and their own income. And they don't let colleagues slack off because they know that any drop in performance reduces their own earnings. As a result, even the lowest-level employees act like managers, looking for ways to reduce costs and improve productivity. One example: A maintenance worker suggested trimming a quarter-inch of cardboard from some packaging, a change that saves Great Little Box thousands of dollars a month. "The less waste, the more profit," says Tyler Martinuk, 53, who operates a die-cutter and has been with the company since 1986. The company expects revenue to reach $35 million in 2010 from $30 million last year. Though it was hit by the recession, Great Little Box has been able to buy struggling rivals, acquiring the assets of two companies since the beginning of 2009, with two more deals in the works.

Dancing Deer Baking in Boston's Roxbury neighborhood has achieved similar results with what the company calls stock options. Since 2001 the small gourmet baker with 63 employees has offered options to all—managers, bakers, and cookie packagers alike—that are sold back to the company when workers quit or retire. Like Great Little Box, Dancing Deer holds regular meetings to discuss finances, and employees are encouraged to find ways to boost profits. Workers this year found that 15 percent of brownies ended up being thrown out because the shape of the pans required the edges to be cut off after baking. New pans cost $35,000, an investment that paid for itself in three months, Chief Executive Officer Frank Carpenito says. From 2004 to 2009, Dancing Deer's sales more than doubled, to greater than $10 million annually.

Even the lowest-level employees act like managers, seeking to keep costs in check

So why doesn't every company use open-book management and profit sharing? Perhaps because it seems counterintuitive. If you're operating on slim margins, can you afford to share the little profit that you're making? A better question might be whether you can afford not to. A survey of *Inc.* magazine's list of what it judges the 500 fastest growing companies in the U.S. reveals that, like Great Little Box and Dancing Deer, 40 percent use open-book management.

I led a six-year global study of companies seeking to improve conditions for employees at every level. After reviewing hundreds of companies from auto-parts makers to drug producers, we did in-depth studies of a dozen of them. Ranging in size from 27 employees to more than 100,000, these companies all make money in part because they improved conditions for all employees. Managers were receptive to suggestions from line workers, who often knew best how to cut unnecessary costs, and they all said the change in working conditions increased productivity. The companies we studied all had managed to achieve one key feat: removing the blinders that can prevent leaders from recognizing that what has worked at the top of the organization can be just as successful, if not more so, at the bottom. Ⓑ

Heymann, author of Profit at the Bottom of the Ladder, *is founding director of the Institute for Health and Social Policy at McGill University in Montreal.*

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SELL YOUR FRIENDS

HOW FACEBOOK PLANS TO LEVERAGE ITS 550 MILLION USERS INTO THE GREATEST ADVERTISING JUGGERNAUT SINCE… O.K., ONLY SINCE GOOGLE. THAT'S STILL HUGE

BY BRAD STONE
PHOTOGRAPH BY MISHA GRAVENOR

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YAHOO AND GOOGLE GRADS: (FROM LEFT) MURPHY, FISCHER, SANDBERG, AND BURNETT LEAD FACEBOOK'S AD TEAM

There were two obvious winners at the FIFA World Cup this summer. Spain took home the 13-pound, 18-carat-gold trophy for its achievement on the field. Nike won the branding championship, thanks largely to a three-minute commercial called "Write the Future," in which its stable of soccer endorsers fantasize about the glory or disgrace that might result from their play in the tournament. Hundreds of millions of people saw "Write the Future" on television. Before it blanketed traditional media, however, Nike launched the video on Facebook, the Web's dominant social network.

The video started as an ad on the site. Then it was passed from friend to friend, often with comments and members recommending it. In the resulting discussions, the clip was played and commented on more than 9 million times by Facebook users–and helped Nike double its number of Facebook fans from 1.6 million to 3.1 million over a single weekend. Getting the ad onto Facebook cost a few million dollars, according to the companies. All that passing around was free. Davide Grasso, Nike's chief marketing officer, says Facebook "is the equivalent for us to what TV was for marketers back in the 1960s. It's an integral part of what we do now."

Marketers have long hoped to turn the Web into the perfect advertising medium. Pop-ups on AOL, banners on Yahoo!, and search ads on Google were steps along that journey. But it's Facebook, the Palo Alto (Calif.)-based social network whose life as a moneymaking business is only now beginning, that may be best positioned to deliver on the Web's promise.

The company has developed a potentially powerful kind of advertising that's more personal–more "social," in Facebook's parlance–than anything that's come before. Ads on the site sit on the far right of the page and are such a visual afterthought that most users never click them. These ads can evolve, though, from useless little billboards into content, migrating into casual conversations between friends, colleagues, and family members–exactly where advertisers have always sought to be.

"The whole premise of the site is that everything is more valuable when you have context about what your friends are doing," says Facebook co-founder and Chief Executive Officer Mark Zuckerberg, who started accepting ads on Facebook as a Harvard sophomore in 2004 in an attempt to cover server costs. "That's true for ads as well. An advertiser can produce the best creative ad in the world, but knowing your friends really love drinking Coke is the best endorsement for Coke you can possibly get."

All this is cause for concern to Facebook's critics–and their numbers among privacy advocates and politicians grow every time the social network pushes the boundaries of the service beyond what its users originally signed up for. People join Facebook to share their lives with friends, yet the information they reveal "is being used by strangers for completely unrelated commercial purposes," says Marc Rotenberg, executive director of the Electronic Privacy Information Center, which filed a complaint to the Federal Trade Commission earlier this year over changes to social network's privacy policies. "That is a little unsettling."

For now, Facebook's appeal to large brand advertisers such as Nike is at least partly a function of its size. Facebook has around 550 million members around the world, about 165 million in the U.S. alone. In contrast, about 106 million people watched this year's Super Bowl–the most watched TV program ever. According to Nielsen, Facebook users average about six hours a month on the site, dwarfing the time spent on old-line portals such as Yahoo and AOL (each about two hours). Speaking at the Cannes Lions International Advertising Festival this summer, Zuckerberg said that reaching a billion members is "almost a guarantee."

Facebook will update the advertising community on its progress on Sept. 27 when, for the third straight year, Facebook Chief Operating Officer Sheryl Sandberg will deliver a keynote speech at New York City's Advertising Week. That's hardly the reason Facebook is permeating the national consciousness, though. *The Social Network*, a film written by Aaron Sorkin (creator of TV's *The West Wing*) and directed by David Fincher (*The Curious Case of Benjamin Button*), premieres on Oct. 1. It portrays Zuckerberg as cutthroat and conniving, an immature prodigy who cruelly betrayed friends during the company's early days. Three Facebook executives, who declined to be quoted about a movie they say takes license with the circumstances of the company's creation, worry that the film could cause members to question their own trust in Zuckerberg and the site, just when Facebook is aggressively building out its advertising business.

Advertisers, at least, haven't expressed any qualms. Executives at many big brand advertisers wax rapturous about the site and are betting heavily on it. "A year ago, Facebook was an afterthought," says Carol Kruse, vice-president, global interactive marketing, at Coca-Cola, which has more than 12 million Facebook fans. "As we go into 2011, it's fully integrated into our marketing plans, with a reliance and a focus on it."

Facebook's ad business is already beyond the promising stage. The company is expected to bring in revenues of $1.4 billion in 2010, Bloomberg reported earlier this year. That's about where Google was in 2003, during a similar time in the development of its now ridiculously profitable search ad network. Facebook, which remains private and has no immediate plans for an initial public offering, doesn't comment on revenue estimates. Sandberg says they're working with more major advertisers and earlier in the planning stages of their big campaigns.

As important as technology is to Facebook's success, Sandberg, 41, runs a close second.

ZUCKERBERG HAS SAID THAT REACHING A BILLION MEMBERS IS "ALMOST A GUARANTEE"

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After working for Lawrence Summers in the 1990s at the World Bank and later as his chief of staff at the Treasury Dept., she moved to Silicon Valley to oversee the ad business at Google. In 2008 she left Google for the experience of running a startup—and because she believed Facebook was the better bet to win in brand advertising, which accounts for 90 percent of the $600 billion ad market. "We are in a much bigger market than Google, and we have much, much more runway," says Sandberg.



ANTOINE ANTONIOL/BLOOMBERG

"KNOWING YOUR FRIENDS REALLY LOVE DRINKING COKE IS THE BEST ENDORSEMENT FOR COKE YOU CAN POSSIBLY GET," SAYS ZUCKERBERG

John Wanamaker coined the advertiser's dilemma—"Half the money I spend on advertising is wasted; the trouble is I don't know which half"—nearly a century ago. Until the advent of the Web, it was hard to argue that the percentages, or even an advertiser's ability to track them, had improved much.

The Web has now advanced to the point that most large sites can serve ads based on a user's browsing history. Google, which intercepts users at the vulnerable moment when they're searching for information, has ridden its refined brand of targeting to $23.6 billion in revenues last year. Facebook takes targeting even further. If you recently got engaged and updated your Facebook status to reflect it, you might start seeing ads from jewelers in your hometown. They've likely used Facebook's automated ad system to target recently engaged couples living in the area. If your profile mentions your appreciation for old-school hip-hop, the right local wedding DJ can find you, too.

David Belden, founder of Residential Solar 101, a San Francisco reseller of solar panels, knows exactly who his customer is: male, around 55 years old, and with an environmental conscience often demonstrated in the ownership of a hybrid car. That's right in Facebook's wheelhouse. "I can target my exact audience, rather than trying to come up with a proxy for it," like looking at search terms or which websites people visit, says Belden, who was spending about $4,000 a month on Facebook earlier in the year before he was forced to rein in his marketing expenses because of budget issues. He adds: "If I was bidding on expensive Google keywords like 'solar,' I'd be going against guys with a much larger marketing budget."

Half of Facebook's members check the site every day. Most update their status, use Facebook e-mail or chat, and upload photos without noticing the timid advertising on the side of the page. Limited to small rectangular boxes with a photo and only 160 characters of text, the average ad is clicked on by less than a tenth of a percent of the site's users, according to advertisers and analysts, including Greg Sterling, a San Francisco-based Internet marketing consultant. Google ads, which are triggered by searches for specific topics such as "new diet plans" or "SUV or minivan" can draw clicks from up to 10 percent of all searchers. They are also far more expensive.

Those terrible click-through rates limit the overall effectiveness of Facebook's targeted ads—which would matter a lot more if all Facebook were selling was clicks. The site talks up more ephemeral measures such as recall and brand recognition, which it argues can be boosted by social activity that occurs around an ad. Facebook calls its ads "engagement ads," because they ask users to take action: play a video, vote in a poll, RSVP to an event, or just comment or click a button to indicate that they "like" it. The "like" button, which Facebook has gradually attached to just about every piece of content on its site and others across the Web, is intended to convey a general recommendation to a member's friends. So while a great majority of users ignore the great majority of ads on Facebook, the numbers change when, say, an ad for a local restaurant is footnoted by a friend's names: ("Jordan, Jen, and 3 other friends like this").

That social endorsement is a tiny mnemonic designed to make the ad catchier, and it works. Nielsen, which started measuring the efficacy of Facebook ads a year ago, says that if users see their friend "likes" an ad or has commented on it, they are up to 30 percent more apt to recall the ad's message.

If enough of your friends like or comment on the ad, the ad can escape its right-side quarantine and jump into your main news feed, along with the names of your friends and all the conversation around the ad. The advertiser pays nothing for this migration. In the industry, it's called "earned

AD IT UP: COMPARING THE MODELS







media." (Think of a teenager wearing a Nike T-shirt or Ellen DeGeneres enthusiastically talking about a product.)

Here's where Facebook's ad philosophy differs from Google's. The search giant operates under the orthodoxy of traditional media. Just as in a magazine or newspaper, advertising on the site is explicitly labeled and separated from its editorial content–in Google's case, search results are separate from sponsored links. Ads on Facebook, however, can transform into casual buzz inside a user's news feed, the online equivalent of water cooler conversation. Twitter, which is only now starting to develop its own ad system, sits somewhere in the middle. It allows members to "retweet" ads to their followers, an action whose meaning, Twitter executives argue, is more powerful and less ambiguous than "liking" or commenting on an ad.

Facebook's promise to advertisers isn't to get consumers to buy their products–or really even to get them to click through to their website. Instead, it wants to subtly park the advertiser's brand in the user's consciousness and provoke a purchase down the line. More immediately, it also aims to get you to "like" the brand yourself, which then serves as a sort of all-purpose opt-in, allowing the advertiser to insert future messages into your feed.

Advertisers love this setup for obvious reasons. It costs nothing for that company to speak continually to a user via his news feeds once that user has indicated he "likes" a certain brand. It also allows corporations viewed skeptically by the press to have unmediated conversations with their customers and to get those customers to evangelize their friends.

Ford, 7-Eleven, and McDonald's have all recently unveiled products on their Facebook pages, in some cases using their fan groups to help design those items in advance. Starbucks offers coupons and free pastries to its 14 million fans; BP used its Facebook page, with about 40,000 fans, to release statements and photos about its attempts to plug the oil spill in the Gulf of Mexico (and had to contend with a much larger Boycott BP page, with 800,000 fans). Other brands use Facebook to pursue what they describe as their product's "service mission." Special K's page dispenses nutritional tips; Nature Valley ruminates about national parks and nature photography.

"For what could be considered the cost of a 30-second spot, you have a year's worth of conversation with people who love the brand," says Jim Cuene, director of interactive marketing for General Mills, which owns the Nature Valley and Betty Crocker brands. Anton Vincent, marketing vice-president for General Mills' baking products division, adds that Facebook allows the company to "leverage the loyalty" of its best customers. "If someone likes Betty Crocker and they tell that to 150 other people, they are helping us to market our brand. In some ways it's a more credible message to the community."

Many Internet companies focus on building technologies, not sales teams. They create self-service systems to take ad orders over the transom. Facebook has an automated system for smaller advertisers–and a burgeoning army of real-live salespeople.

Thanks to Sandberg, its business staff is divided into three groups, a structure that's identical to Google's. The direct-sales operation–led by

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Mike Murphy, an affable, well-connected former regional sales director at Yahoo–coordinates with the world's top 250 advertisers as well as big interactive agencies such as AKQA in San Francisco and Tribal DDB in New York. Grady Burnett, one of the hundreds of former Googlers who sought out a new challenge and greater financial opportunity at Facebook, oversees inside sales, which reaches out to medium-size companies and tries to get them to maximize their spending on the social network. Burnett also runs the self-service ad system, which brings in about half of Facebook's overall revenues.

People with knowledge of Facebook's operations say it has about 300 sales people–and the number is growing. Facebook currently lists more than 50 sales openings on its jobs board, including positions for head of sales (Italy) and associate manager of ad operations (Dublin). "We very much have the view here that this product has only just begun," says David Fischer, who joined the social network in March as vice-president of advertising from–where else?–Google. "There is a lot more work to do."

One area calling out for attention is Facebook's relationship with ad agencies. Agencies almost uniformly praise Facebook's potential. They also want to flex their creative muscles and do more on the site's pages, but Facebook refuses to allow advertisers to break out of the advertising ghetto. "We do think the creative canvas needs to be a little more flexible, but that is their decision," says Paul Gunning, chief executive at Tribal DDB, which has steered companies such as McDonald's and Johnson & Johnson onto Facebook.

That obstinacy comes directly from Zuckerberg, say colleagues–ironic given that the CEO blessed the blending of ad content and conversation in user's personal news feeds when the site rolled out engagement ads in 2008. Zuckerberg says that ads, just like videos and news links, make it into the main stream of activity only when friends want to share them. "The most important thing for ads is that they work in the same way as everything else on the site," he says. Zuckerberg meets with advertisers "every once in a while" but says that he spends most of his time working on new products and ensuring consistency across Facebook's various services.

"WE ARE IN A MUCH BIGGER MARKET THAN GOOGLE, AND WE HAVE MUCH, MUCH MORE RUNWAY," SAYS COO AND EX-GOOGLER SANDBERG



KIM WHITE/BLOOMBERG

Instead of allowing advertisers to be flashy and creative, Zuckerberg and his colleagues want to provide them with more data to improve their targeting ability. For example, the company recently entered the field of location services, pioneered by outfits such as foursquare, which allows people to "check in" from various physical locations. Use this tool, and Facebook will not only know who you are and what you are interested in, but also where you are and when. That could unlock a potentially rich trove of data for small local businesses, which have had few opportunities to build their brands, save for perhaps Yellow Pages listings and billboards.

FACEBOOK IS EXPECTED TO BRING IN REVENUES OF $1.4 BILLION IN 2010

Earlier this year, Facebook also added "like" buttons to thousands of sites across the Web and to tens of millions of individual pieces of data, such as hockey players on NHL.com and each song on Internet radio site Pandora. The initiative, dubbed the Open Graph, is the fulfillment of an idea Facebook first pursued disastrously in 2007 with its Beacon service, which broadcast information about people's Web purchases to the site without their explicit permission. By exporting its "like" button across the Web, Facebook can get people to volunteer their tastes and preferences and then develop more comprehensive psychographic profiles on its members.

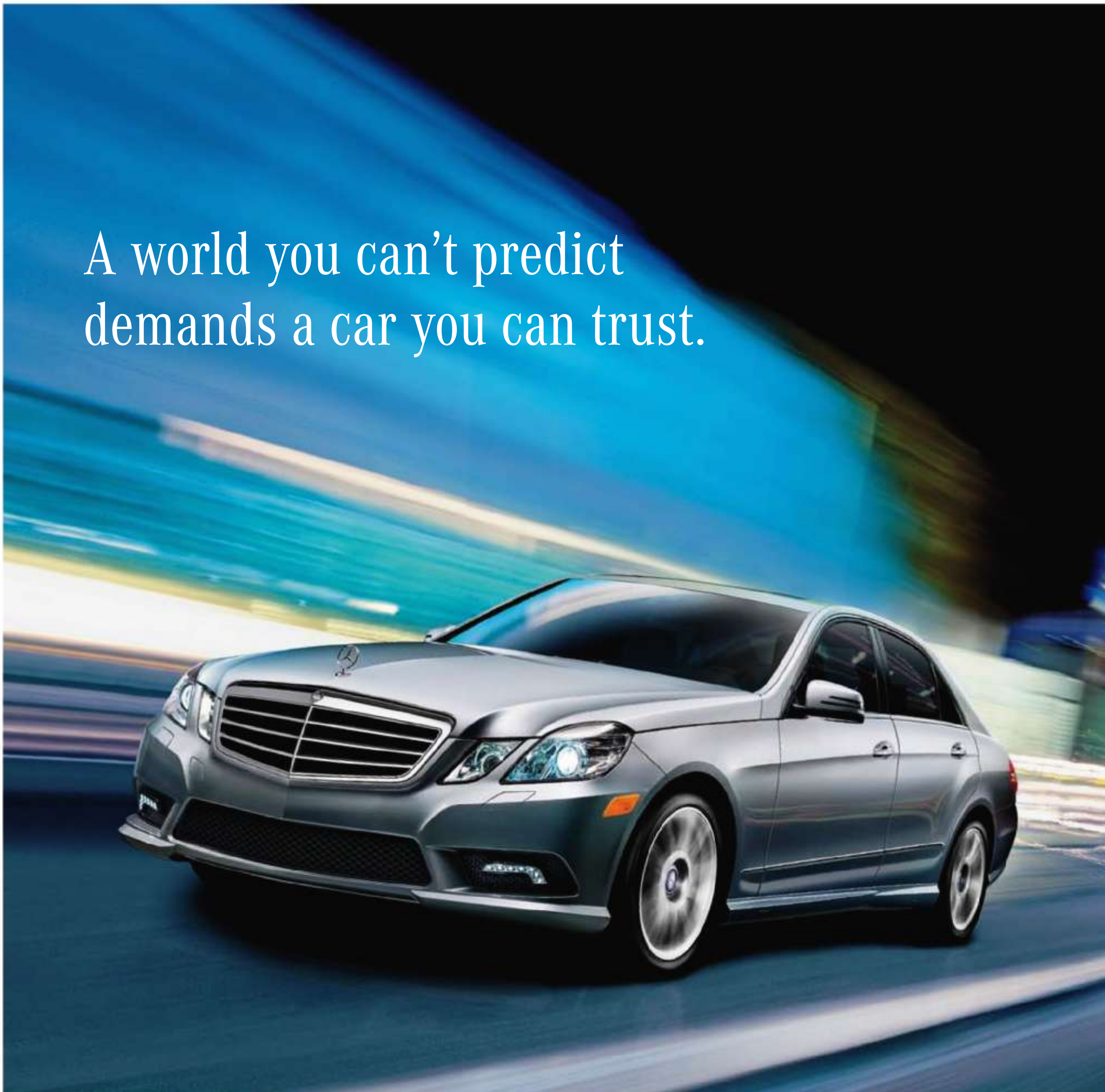
The new data could also help advertisers find pools of potential customers, using a technique called "predictive targeting." All that "like" data streaming into its servers could let Facebook figure out that an advertiser selling pasta sauce, for example, has a viable audience in members who like a particular hockey player or stream a certain type of song.

Data collection companies such as Quantcast, BlueKai, and Media6Degrees have provided this kind of service for years by recruiting panels of volunteers, tracking their online behavior, and extrapolating common characteristics. Advertisers can also use Google to make connections between, say, people who search for good restaurants and their interest in booking travel plans. But with the new data, Facebook is poised to make these statistical leaps.

Facebook quietly rolled out an ad tool called "learned targeting" last year, which lets companies pitch ads to the friends of their existing fans or to people that Facebook believes share common attributes. Bowen Payson, manager of online and digital marketing at Virgin America, calls this "a marketer's dream." Unlike other data collection companies, Payson says, this kind of targeting on Facebook "is not based on intuition or science. It's more based on real-

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ity." He plans to begin experimenting with the service later this year.

The challenge for Facebook is how to evolve its pioneering advertising capabilities without mobilizing its opponents. "The fact of the matter is that Facebook is built on a viral marketing house of cards," says Jeff Chester, founder of the Center for Digital Democracy and one of Facebook's fiercest foes in Washington. He wants regulators to force the company to be more transparent about its data collection habits. "It's all about getting, through largely stealth means, a consumer to endorse a product or a brand and to communicate that to their network of friends," he says.

Facebook objects to the notion that it is doing anything secretly, though the heated rhetoric has the company moving cautiously. It has revised its terms of service and privacy policies–to much controversy–and rolled out granular privacy tools that let members manually control the flow of information to and from certain friends. It does not, however, allow members to withhold data from its ad targeting system.

The company also has an obvious opportunity: to offer its ad network to the rest of the Web, as Google does with search ads and Yahoo does with display. Facebook could easily extend its targeting capabilities to the tens of thousands of websites that now use its "like" buttons and allow people to log in with their Facebook user name and password. The company also could offer to fill parts of these sites' ad space while taking a cut. Jeremiah Owyang, an analyst at Altimeter Group, says that such an ad network is a "ripe opportunity" and likely goal for Facebook, but it will not happen right away. "They test everything and like to take things slow," he says. COO Sandberg says: "We are not working on that now. I'll let you decide whether that makes sense."

Hundreds of millions of people around the world "like" Facebook. It's useful, and thus far Zuckerberg and Sandberg have walked the line between providing a service to members and a platform to advertisers. With each technological advance and product rollout, though, the line moves. And it's not yet clear how those hundreds of millions of people will feel when they realize they've been permanently joined on the site by advertisers who are not all that interested in friendship. Ⓑ

AT THE MOVIES WITH: THE WINKLEVOSSES

"THE REAL-LIFE MARK ZUCKERBERG HAS NEVER SHOWN THAT INNER TURMOIL"


Tyler Winklevoss

"HIS BEHAVIOR WAS UNETHICAL"


Cameron Winklevoss

"It's a little surreal," says Cameron Winklevoss, standing outside the Sony office building in midtown Manhattan with his twin brother, Tyler. "Like hearing your voice on an answering machine."

The Winklevoss brothers have just joined a *Bloomberg Businessweek* reporter for a screening of David Fincher's taut and suspenseful film *The Social Network*, which opens on Oct. 1. The movie depicts the hydra-headed controversies over the origin of Facebook, including the allegation that Harvard sophomore Mark Zuckerberg agreed to write code for the twins on a similar social network before surreptitiously starting Facebook and riding it to riches. The brothers, both portrayed in the film by actor Armie Hammer, resolved their litigation with Facebook for $65 million in 2008, though they are now contesting the settlement, hoping to get more.

The Winklevosses, strapping Olympic rowers who look exactly alike, are fairly surreal offscreen, too. They dress preppily, carry identical gray Tucano man purses, and occasionally bicker over how to best answer questions.

Like everyone else in the movie, the picture of the Winklevosses that emerges from screenwriter Aaron Sorkin's acid-tipped pen is not flattering: They are portrayed as pampered athletes with no high-tech chops who come up with the kernel of a business, then do little more than act distraught when Zuckerberg fleshes out the idea and makes it his own. "I think we're fairly confident that the truth speaks for itself," Cameron says.

As the twins cab to a restaurant, zipping past billboards for the film with actor Jesse Eisenberg as Zuckerberg, they pick a few nits. They forged their initial partnership with Zuckerberg in the Kirkland House, a Harvard dorm, and not, as the movie depicts it, at the Porcellian, one of the exclusive undergraduate clubs to which the Zuckerberg character pines for ac-cep-tance. Cameron says he never chased Zuckerberg through the Harvard quad; and Tyler thinks that Eisenberg's mournful eyes at the end of the film reveal more guilt than the Facebook chief executive officer ever actually expressed. "The real-life Mark Zuckerberg," he says, "has never shown that inner turmoil in the six years I've dealt with him."

They think parts of the movie are dead-on. In one pivotal scene, then-Harvard President Lawrence Summers brusquely dismisses the twins' claims, telling them to get over it and start another business. "It definitely captured the tenor of Larry Summers and how he dealt with us, the lack of tact," Tyler says. "We came into the office not feeling good about the situation, and we left feeling certainly a lot worse."

The Zuckerberg character gets the last word on film, saying the brothers are suing because, for the first time, life hasn't worked out as they had planned. The twins spend a good deal of time discussing and rejecting the idea that they felt any sense of entitlement, while pointing out that Zuckerberg had a similarly privileged childhood. "There is no entitlement in the sport of rowing. There is no entitlement in the Olympic Games, and quite frankly there is no entitlement to gaining admission to Harvard," Cameron says. "The reason we were upset," he continues, "is not because life didn't work out the way it should have, but rather because what he did was wrong. His behavior was unethical."

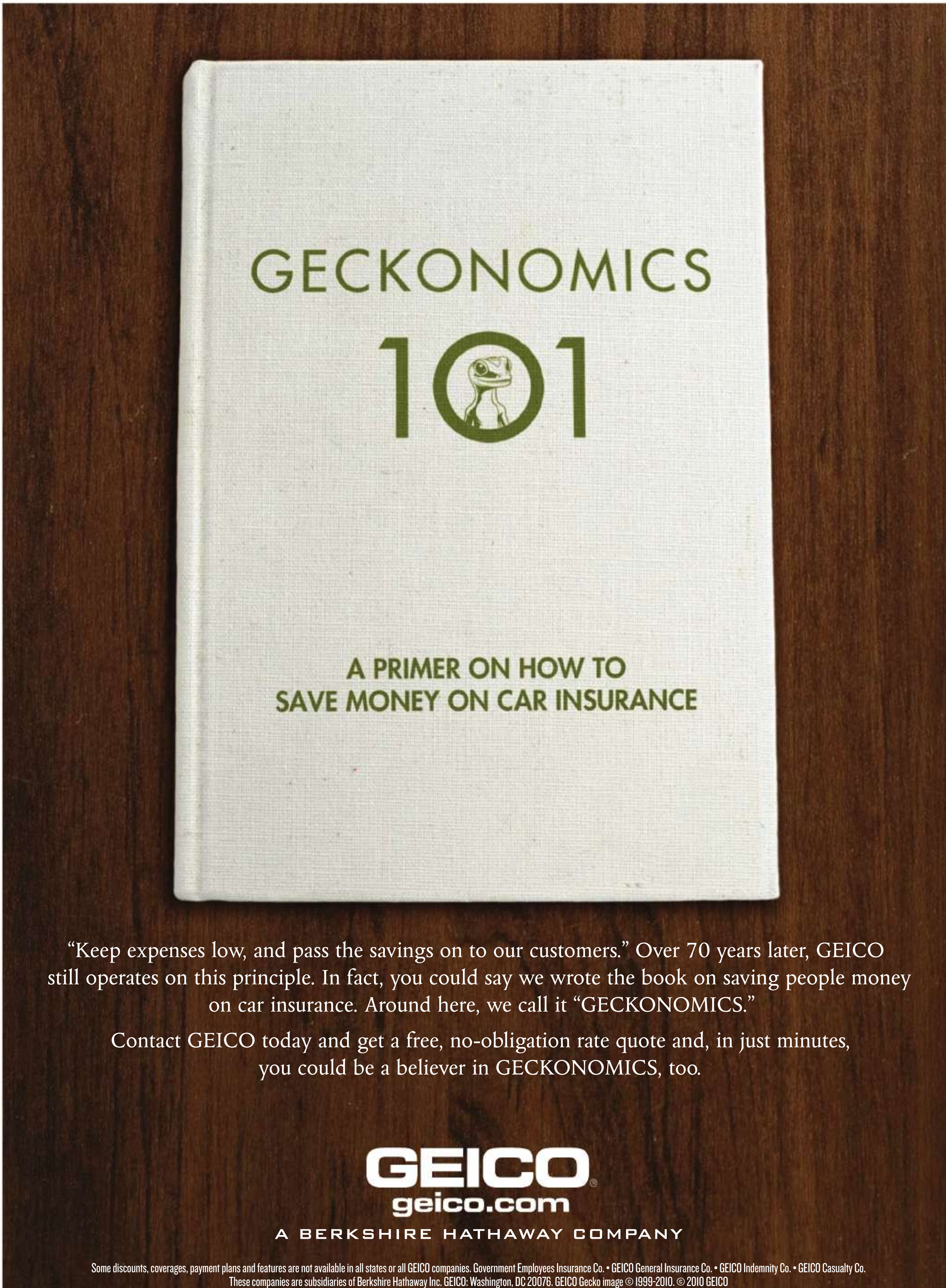
As the discussion concludes, the brothers agree others in the movie fare a lot worse—such as early Facebook President Sean Parker, devastatingly portrayed by Justin Timberlake as a narcissistic clown, and Zuckerberg, who avenges social rejection by creating perniciously viral websites and punishing his closest friends. "There are other individuals portrayed in the movie that have a lot more to be concerned about," says Tyler. About their own characters, "I felt you saw guys who were acting within the system, who went about things the right way."

"But I don't wear ear warmers," Cameron adds. "That's something that is not real." Ⓑ —*Brad Stone*

BRIAN SNYDER/REUTERS (2)

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Thomas Hoenig is Fed Up

Within the Federal Reserve, there is one very powerful voice of dissent.

By Paul M. Barrett and Scott Lanman
Photograph by Alex Majoli

Thomas M. Hoenig, dressed in a gray suit, white shirt with French cuffs, and baby-blue tie, faces an edgy crowd of 150 people in a hotel meeting room in suburban Lenexa, Kan. A large "Kansas City Tea Party" banner covers a table at the door. Attendees wear anti-tax stickers on their lapels. This is not an after-dinner speech for which most central bankers would volunteer.

Hoenig heads the Federal Reserve Bank of Kansas City. This year he also serves as a voting member of the powerful Federal Open Market Committee in Washington, which controls interest rates and the money supply. Many of those just now finishing their chocolate-chip bread pudding dessert at Lenexa's Crowne Plaza Hotel would like to see Hoenig lose his job. Nothing personal: They just consider the Federal Reserve an affront to the Constitution and want to shut it down, lock, stock, and vault.

Hoenig smiles at his audience and begins: "This is a support-the-Fed rally, right?"

Dead silence.

Then the room erupts in laughter. Disarmed, the Tea Partiers listen politely as Hoenig defends the Federal Reserve as an indispensible institution, even if at the moment, he says, it happens to be heading in the wrong direction.

And, by the way, if it were up to him (though it's not, really) he would break up the biggest Wall Street banks.

The applause starts tentatively, then builds to respectful appreciation. Afterwards, Steve Shute, a leader of the Hope for America Coalition, the Kansas group that sponsored the dinner, compliments Hoenig for impressing a tough crowd. "We believe the Federal Reserve should be abolished," he says. It "is helping to destroy the country." That said, Hoenig seems like an O.K. guy. "He is someone going toe-to-toe with Ben Bernanke and the Boston-New York-Washington-San Francisco elite axis at the Fed. He brought some Midwestern common sense to the Fed," says Shute. "We know he doesn't agree with us, but we're still proud of him."

This is Tom Hoenig's moment, and it's a strange one. In Washington, he is the burr in Fed Chairman Bernanke's saddle: the rogue heartland banker who keeps dissenting alone—for the sixth straight time on Sept. 21—to protest the Fed's rock-bottom interest-rate policy. Hoenig warns that the Bernanke majority is setting the country up for an as-yet-unknown asset bubble: the next dot-com or subprime craze. He can't tell yet where the boom-and-bust will materialize, but he can feel it coming, like a Missouri wheat farmer senses in his bones the storm that's just over the horizon.

Hoenig's outlying position seemed less eccentric earlier this year, when the recovery had more zip. "To continue to hold it through the kind of deterioration in the economy we've seen the past couple of months is, to me, quite puzzling," says Lyle Gramley, a Federal Reserve governor in the 1980s who works as a senior economic adviser with Potomac Research Group in Washington. Paul Krugman, the Princeton University Nobel laureate and *New York Times* columnist, has written that Hoenig and a couple of other Fed presidents from the provinces have intimidated Bernanke out of taking more aggressive steps to stimulate job growth.

"I think that's nonsense," Hoenig fires back. His irritation reveals how much he takes the disagreement to heart. Says Richard W. Fisher, president of the Dallas Fed and a Hoenig friend: "I know Tom anguishes over this. He and I have talked about it."

Hoenig's plainspoken rebellion has put him in the headlines, on cable television, and, in some cases, in the crosshairs for vituperative attacks. "In this environment, with 9.6 percent unemployment, Hoenig's position is just friggin' nuts," says Dirk Van Dijk, director of research at Zacks Investment Research in Chicago. "His idea for tightening monetary policy is roughly equivalent to a doctor giving anticoagulants to a patient suffering from severe internal bleeding." Part of Hoenig's pain comes from being typecast as a heartless inflation hawk, indifferent to the common man who can't find work. The son of an Iowa plumber, he argues that it's not primarily inflation he fears but the reckless borrowing and distortions engendered by sustained low interest rates. The hard truth, in his view, is that there just isn't much more the Fed can do to help, and we all ought to admit that.

While persisting in this lonely campaign for the end to ultra-easy credit, Hoenig has also been a harsh critic of Wall Street excess (an issue on which he and Krugman mostly agree). In abundant speeches and articles, Hoenig has condemned the political influence of the financial elite. "We've had a Treasury Secretary from Goldman Sachs under a Democratic President and a Treasury Secretary from Goldman Sachs under a Republican President. The outcomes were not good," Hoenig says while being driven to a luncheon talk at an affordable housing conference in Topeka, Kan.

All of this—the prairie populism, foreboding about bubbles, and glass-half-full economic perspective—has made Hoenig a hero in the seven-state Kansas City Federal Reserve District (Kansas, Colorado, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico, and the western third of Missouri). "Tom has seen the good, the bad, and the ugly, so people listen to him out here," says Terry Moore, the president of the Omaha Federation of Labor of the AFL-CIO and a member of Hoenig's board of directors at the Kansas City Fed. Moore acknowledges that unions generally have pushed for a degree of monetary stimulus that Hoenig resists. But the AFL-CIO leader trusts the banker: "We feel like Tom represents a heartland view of the economy you don't necessarily get from New York or Washington. He's an old farm boy from Iowa, and we like that."

Hoenig, 64, the grandson of corn and wheat farmers, doesn't affiliate with a political party, doesn't give campaign contributions, and definitely won't say who got his vote for President in 2008. A product of Catholic schools and Benedictine College in Atchison, Kan., he served in a combat artillery unit in Vietnam, and has spent his entire 38-year career at the Kansas City Fed. One reason he is speaking out now, he says, is that he has only 12 months before mandatory retirement will force him to leave, and he has decided he won't go quietly.

In the middle of the country, economic conditions are better than on the coasts. Lifted by exports, agriculture is booming. That helps explain Hoenig's instinct that it's time to get interest rates off zero.

As popular as he is in the region, there are plenty who disagree. "It seems odd to me that with 200 economists at the Federal Reserve in Washington, that Tom Hoenig has discovered some wisdom that escaped all of those people," says Lou Barnes, a veteran banker who tracks the Fed for Premier Mort-

Prairie populist: Hoenig after being named president of the Kansas City Fed in 1991



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gage Group in Boulder, Colo. "There's something undignified about all the dissenting and the questions it raises. ... It makes you wonder whether he's grandstanding."

Funerals for Banks

Hoenig grew up in Fort Madison, Iowa. Locals called it Pen City because it was home to both the state penitentiary and the original Sheaffer Pen factory. Maximum-security inmates still reside in Fort Madison; the pen company is now owned by Société BIC. Hoenig carries only black Sheaffer fountain pens in his shirt pocket.

The second-oldest of seven siblings, he started taking inventory for his father's contracting business at the age of 9. "I don't know if it was legal or not," he says, reminiscing in the wood-paneled library off his office on the 14th floor of the grand limestone Fed building overlooking downtown Kansas City, Mo. A thousand people work for Hoenig here, ranging from PhD economists to the technicians who oversee the automatic forklifts moving pallets of $100 bills in and out of the spotless first-floor vault.

Economics was a natural part of Hoenig's childhood: "You basically kept expenses within revenues. That's what you were taught ... and you saved."

He enjoyed economics more for the mechanics than as an ideological template. After Vietnam, he obtained a PhD at Iowa State. Asked for an intellectual influence, he offers Milton Friedman, but adds that it was the University of Chicago scholar's empirical history of U.S. monetary policy that he found inspiring, not Friedman's anti-regulatory passions. Hoenig joined the Fed staff in 1973 in Kansas City, hometown of his wife, Cynthia. They raised two sons, Michael, a lawyer, and Alex, who works in commercial real estate.

The D.C.-based governors of the Federal Reserve—seven at full strength—are Presidential appointees, subject to Senate confirmation. They serve 14-year terms and direct monetary policy through the Federal Open Market Committee. The presidents of the 12 regional Fed banks, by contrast, are chosen and employed by the banks' private-sector directors. The regional banks are public-private hybrids: They both regulate and provide services to for-profit banks. The quasi-private-sector regional presidents have lower profiles than the politically appointed Fed governors, but the presidents are much better paid. Hoenig, who has held his current post since 1991, making him the longest-serving president, earned $374,400 in 2009. Bernanke earned $196,700.

Hoenig relishes the memory of his early years at the Kansas City Fed in the 1970s. For a bookish young economist, writing reports on competitive conditions for agricultural finance was as good as it gets. Later in the decade, he moved up to hands-on bank supervision, around the time that low rates ignited aggressive bank lending in the Midwest and sharp runups in the prices of agricultural land and domestic oil and gas operations. Those real estate and energy bubbles burst with a vengeance in the early 1980s, forcing thousands of farms into foreclosure, pushing small towns to the brink of depression, and bringing down 347 banks in the Kansas City Fed's district from 1982 to 1992. Working with colleagues at the Federal Deposit Insurance Corp., Hoenig personally helped administer more than 100 funerals for failed community banks. He recalls a memorable July 4 weekend in 1982 in his office at the Kansas City Fed, poring over the books of Penn Square Bank, an especially reckless Oklahoma City energy lender. Its executives pleaded for a bailout. "It's not

> "You basically **kept expenses within revenues,"** Hoenig says of his Iowa childhood. "That's what you were taught."

salvageable," Hoenig, then an assistant vice-president, recalls telling his bosses. They let Penn Square go under. The Oklahoma City contagion spread to numerous larger banks that had purchased Penn Square's loans. The debacle contributed to the collapse two years later of giant Continental Illinois in Chicago, the largest bank failure in U.S. history until the crisis of 2008.

"What I took from that," says Hoenig, "was that it followed a period of very easy credit. It followed a period when people felt prices could only go up." Feel-good rates, in other words, led to excessive leverage and crisis. "I find it very interesting today," Hoenig continues, "how many people don't remember the late 1970s-early 1980s."

Under the leadership of then-Chairman Alan Greenspan, the Fed drove rates down in response to the dot-com crash of 2000 and the recession that followed. Hoenig had a turn as a voting member of the FOMC in 2001 and dissented twice that year from rate-lowering moves, even after the September 11 terrorist attacks exacerbated the economic slowdown. Greenspan and Bernanke, who assumed the Fed chairmanship in 2006, have insisted that easy-credit policies during the early 2000s didn't contribute to the housing bubble and Wall Street crisis. Hoenig disagrees. "The low rates in that era accommodated too much borrowing, too much leverage, too much risk-taking," he says.

Hoenig harbors powerful misgivings over not dissenting more often and more forcefully during the Greenspan years. "He regrets going along with the votes when Alan Greenspan was chairman to get rates so low and keeping them so low so long," says his friend Fisher. In an interview, Greenspan says: "He's a person with an independent point of view." He declined to comment on Hoenig's regret about his votes. Bernanke declined to comment for this article.

The crisis of 2008 required extraordinary actions from the Fed to head off a global depression, Hoenig acknowledges. These included bank bailouts, huge asset purchases to boost liquidity, and severe interest-rate cuts meant to stimulate hiring and growth. Beginning in the third quarter of 2009, however, he started urging his Fed colleagues at their periodic meetings in Washington to send a signal that they would "renormalize" by slowly moving rates up. In 2010, Hoenig was empowered with his once-every-three-years turn to vote—and decided to use it.

His argument, in brief: Despite continuing high unemployment, a modest recovery is actually under way. Personal income and expenditures are up in 2010, if only slightly. Businesses are slowly adding back jobs, more than

700,000 so far this year. But the Fed has consistently maintained that near-zero interest rates are here indefinitely. "In trying to use policy as a cure-all," he said in a speech to the Chamber of Commerce in Lincoln, Neb., on Aug. 13, "we will repeat the cycle of severe recession and unemployment in a few short years by keeping rates too low for too long."

This is a minority view within the economics fraternity. Most experts are fixated on persistently high unemployment and the danger of the country slipping back into recession. In a column in *The New York Times* on Aug. 12 entitled "Paralysis at the Fed," Krugman asserted that Bernanke "is being political, unwilling to engage in open confrontation with other Fed officials–especially those regional Fed presidents who fear inflation, even with deflation the clear and present danger."

Hoenig counters that Krugman simply wants Bernanke to "agree with Paul and then make everyone else agree with Paul." Hoenig says he cannot push around anyone in Washington. If anything, he seems frustrated that other voting FOMC members who have expressed sympathy for his views are still backing Bernanke when it comes time to vote. "I'm a human being. I think I'm right, or I wouldn't vote that way," he says. "If they agree with me, I wish they would join me."

FOMC Etiquette

The Fed's internal deliberations take place in a decorous atmosphere. Visiting regional presidents stay in the same West End hotel, the Fairmont, and eat breakfast together at the white marble Fed building on Constitution Avenue, Northwest. Conversation is friendly, arm-twisting nonexistent, Hoenig says. "No one has ever lobbied me, and I have never lobbied anyone."

The Fed governors and regional presidents each have an opportunity to present their view of the economy and, after a break for lunch, their prescription for monetary policy. Under rules established by Bernanke, participants raise one hand to get on a list to speak and two hands if they wish to interrupt a colleague for clarification or to dispute a point. "I've done it on occasion," Hoenig says.

Some former colleagues wonder aloud what is driving Hoenig to register repeated objections to Bernanke's leadership. "He's a very practical, cautious person, I would say not given to dissenting easily," says Robert McTeer, who served as Dallas Fed president from 1991 through 2004. Hoenig's position made more sense earlier in the year, when the economy looked stronger, McTeer adds. "I think he's hung up on this issue now in ways that make it difficult for him to back off," says Gramley, the former Fed governor.

Hoenig's actions become more comprehensible if one attends a breakfast gathering of community bankers at the Kansas City Fed. He hosted such an affair in early September. While attendees sip coffee, Bruce A. Schriefer, president of Bankers' Bank of Kansas in Wichita, rises to ask, only half-jokingly, whether one day soon he and his fellow executives "will all be working for Goldman Sachs or Wal-Mart?"



Axis of antagonism: Hoenig has had disagreements with Greenspan, Bernanke, and Krugman

"I understand," Hoenig murmurs. Throughout the morning, the sense of regional pride, even defiance, is palpable. Hoenig, sounding like an old-time football coach, tells his guests that the more than 1,000 small banks they represent have a "fundamentally sound" business model and serve the noble cause of nurturing Main Street. The little guys need to stick together.

Another reason Hoenig wants to end super-low interest rates is that Wall Street banks and large corporations are currently able to borrow for almost nothing and either hoard cash, make acquisitions, or invest in long-term Treasuries for a guaranteed profit. Retirees and other bank depositors effectively subsidize this borrowing and earn almost nothing on their savings. "It's a distortion, and it favors the large institutions over the smaller ones and Wall Street over the saver," Hoenig says in an interview. "I just don't like it. It's not fair."

When community banks stumble, he adds, they are allowed to fail. When Wall Street collapsed, it got a heroic rescue. "I would break them up," Hoenig says of Citigroup, JPMorgan Chase, and Bank of America. "They're too big. They have too much political influence. When they get in trouble again, the temptation to rescue them because they are 'too big to fail' will be very strong." The financial reform legislation enacted in July wasn't tough enough; he would have liked to see the Glass-Steagall Act's separation of commercial and investment banking revived, along with the imposition of strict capital requirements on the banks by Congress.

Despite his dissent on monetary policy, Hoenig argues that a strong central bank is vital. At the Tea Party dinner in Lenexa, he says: "I know many of you believe in 'End the Fed.'" That's your prerogative, he continues. But "you better have something else in mind" as a replacement. He gives a quick and chilling history lesson of U.S. financial panics before the Fed system was created in 1913.

Some in the audience are not convinced. A bearded man approaches Hoenig after the talk and suggests that the Fed is part of a conspiracy "to collapse the United States" and establish a "one-world financial system."

Hoenig wearily shakes his head. This is his third public event of the day, and it is 9 p.m. "Sir, I know times are tough," the central banker says, "but why in the world would we do that?" B

"I think he's hung up on this issue now," says Gramley, "in ways that make it difficult for him to back off."

FROM LEFT: STEPHEN CROWLEY/THE NEW YORK TIMES/REDUX; JOCEYLYN AUGUSTINO/REDUX; MIKE CLARKE/AFP/GETTY IMAGES

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Morningstar *FundInvestor*, June 2010. Morningstar evaluated the 30 largest fund groups (based on asset size) on the following measures: manager retention rates over the last 5 years; fund management tenure (how long the portfolio managers have managed their funds); fund managers' investment in the fund they manage; 3-year asset-weighted performance of all share classes; and Morningstar Stewardship Grades, which evaluate a fund group's culture, fees, Boards of Directors, manager incentives, and regulatory records. Data used were as of 5/31/10 except for manager retention, which is through 12/31/09.

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The Ultimate Driving Machine.

is a tiny little electric car

BMW CEO Norbert Reithofer knows the future is about more than high-performance suburban status symbols. By Chris Reiter

When former U.S. Secretary of State Madeleine Albright arrived for lunch with BMW Chief Executive Officer Norbert Reithofer in late 2008, she brought along an unexpected guest, Joschka Fischer, a one-time left-wing radical. In the early 1970s, Fischer was fired from GM's Opel unit for trying to organize a communist revolution among his fellow workers, and in 1973 he was photographed clubbing a police officer in a street protest. Later, disavowing violence, he entered mainstream politics, rising to prominence in the Green Party and serving as German foreign minister from 1998 to 2005.

Now he has a new job. After that lunch, Reithofer hired both Fischer and Albright to help BMW win support within the company and around the world for its Megacity Vehicle. Battery-powered, and built of carbon fiber and aluminum, it is meant to win BMW a place in the fastest-growing markets—sprawling urban megalopolises.

"The Megacity Vehicle is a must-have for BMW," says Reithofer at the company's landmarked headquarters in Munich. Reithofer, who has been at BMW for 23 years, is an unprepossessing man of 54, rarely seen in anything but a dark, three-button suit, with all three buttons fastened. He lives in the same modest Bavarian village where he was born. He owns a beagle. But with this new vehicle, Reithofer is attempting something radical, pushing BMW beyond its core strengths of speed and style, and toward solving different problems, like global warming, oil depletion, and the shift in growth from the West to the East. China is, in a sense, the ultimate destination, a land of exponentially growing megacities—and the pollution, traffic snarls, and huge spending power that come with them.

Reithofer's challenge is to secure a place for BMW in this new world without sacrificing its status as a rarefied drive for the open road. "We don't see threats; we see opportunities," says Adrian van Hooydonk, an 18-year BMW veteran whom Reithofer installed as design chief last year. "That's an indication of how this company thinks and the kind of energy that Dr. Reithofer brings to the company. 'It is what you make of it,' that's what he always says."

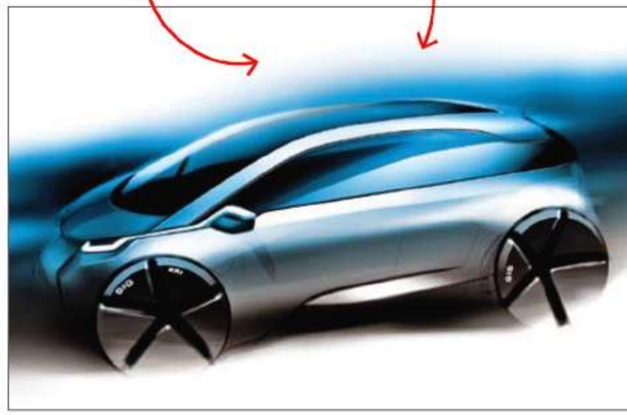
Inside BMW, the Megacity message didn't immediately resonate with all of BMW's horsepower-driven man-

Quiet radical: CEO Reithofer is rethinking BMW



ILLUSTRATION: TIM GOUGH; REITHOFER: GUENTER SCHIFFMANN/BLOOMBERG

Concept sketch for the Megacity Vehicle



agers. Their resistance is understandable: BMW is doing quite well as is, building beautiful cars that go fast. In 2005, it bested archrival Daimler's Mercedes-Benz in sales, and the company has come roaring out of the recession, expecting to sell 1.4 million vehicles this year, just off its 2007 peak, while raising margins to 6.6 percent. With both the trendy Mini badge and Rolls-Royce's silver lady under BMW control, the Bavarian manufacturer is on more solid footing than at any time in its 94-year history. Despite its success, however, BMW is still a much smaller company than its rivals. It lacks the giant bus and truck operations that allow Mercedes to amortize research costs. Volkswagen, with a stable of 10 brands including Bentley, Porsche, and the aggressive Audi nameplate, sells nearly five times as many cars as BMW and has vowed to topple it as the biggest premium automaker by 2015. "Because of its size, BMW can't allow itself any mistakes," says Stefan Bratzel, director of the Center of Automotive at the University of Applied Sciences in Bergisch-Gladbach, Germany, and a former manager at Daimler's Smart unit. "If the Megacity Vehicle doesn't work, BMW will have considerably less room to maneuver."

Reithofer grew up in Penzberg, a former coal-mining town about 50 kilometers (30 miles) south of Munich. Living a short distance from the house where he was born, he's stayed in the area to be close to family and the Alps, where he unwinds by skiing and mountain biking. After studying machine tools and operating science under Joachim Milberg, BMW's former CEO and current chairman, he joined BMW in 1987 as head of maintenance planning. Later he moved to South Africa as technical director of BMW's plant in Rosslyn. From 1997 to 2000 he managed BMW's factory in Spartanburg, S.C., where the company manufactures the X5 and X6 lines of sport-utility vehicles. He credits his stint in the U.S. with streamlining his management style.

"In the U.S., I learned to take quick decisions and not hold long speeches," he says. "When I got back to Munich, it struck me right away how long it took to make decisions, but we've changed that now."

Part of his plan for the Megacity project has been to leave some of the long speeches to Albright and Fischer. The two spoke separately to auditoriums filled with hundreds of BMW executives and engineers, discussing trends like urbanization and global warming that threaten to make BMW's athletic sedans obsolete. The result has been a groundswell of enthusiasm for the electric-car program, which came out of Project i, BMW's internal think tank for the future of transport.

Ulrich Kranz, a former Mini developer, runs Project i, and says more people want to work for the unit than he can hire. Project i has grown from a handful of diverse experts in late 2007 to a team of more than 250 people, as BMW readies for the launch of the Megacity Vehicle in 2013. "Reithofer has provided more than 100 percent support," says Kranz. "He is an absolutely enthusiastic motivator."

95 MPH

projected top speed of Megacity Vehicle

He's also a listener, and that helped BMW navigate the financial crisis without slipping into the red. In late August 2007, on a routine swing through the U.S., Reithofer met for a light lunch with a half dozen of BMW's top American dealers. The meeting at the carmaker's customer center near its factory in Spartanburg was upbeat; sales were heading for a record that year. When conversation turned to prospects for 2008, however, the salesmen voiced concern about credit markets and warned that problems in the subprime market could spill over and hurt demand.

Reithofer could have been forgiven for ignoring the warning. It was after all more than a year before Lehman Brothers' failure set off the financial crisis. Instead, when he returned to Munich, he started putting crisis plans in place. The early warning helped BMW scale back production quickly, which prevented a glut of unwanted cars eating up cash and depressing prices. The company trimmed 11,000 workers from its payrolls through attrition and buyouts, and reduced hours for another 25,000, but was able to get through the crisis without layoffs.

Reithofer also used the crisis to reduce purchasing expenses and lower development costs, hoping to move profit margins to at least 8 percent by 2012. "The crisis accelerated the process," says Reithofer, who personally test drives competitors' vehicles and visits dealers anonymously to get an unfiltered view of his company. "We're farther along than we otherwise would have been," he says. That progress is reflected in the company's stock performance. The shares have risen 50 percent this year, outperforming Daimler's 20 percent advance and Volkswagen's 40 percent gain.

"Reithofer was very underrated when he came in, but he's since become one of the most respected CEOs in the industry," says Philippe Houchois, an analyst with UBS in London. "He's not flashy but rather an inside guy who gets the work done."

Reithofer's strategy is based on maintaining BMW's independence, keeping in mind the rescue funded by Herbert Quandt, who had inherited a stake in BMW from his father. In 1959, BMW was losing money and needed cash to develop a mid-market car. Mercedes' parent, then called Daimler-Benz, made an offer for BMW, which was rejected by Quandt because of opposition by the workforce and small shareholders. Quandt scraped enough money together to provide BMW a lifeline, and today his descendants still own nearly 47 percent of the carmaker. Says Reithofer, "The advantage of our major shareholder is—among other things—that they give us the stability to think long-term."

The long view has pushed BMW to build electric vehicles and the smaller cars that will be needed in the new urban

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2013

Launch date for Megacity Vehicle

world. BMW staff traveled to Tokyo, Mexico City, and Los Angeles, among others, to talk to mayors, city planners, and even regular folks, whom they followed on their commutes and into their homes to see how they lived and traveled. They determined that a car still had a place in crowded cities as a symbol of individuality and refuge from the bustle, but it had to be sustainable.

Tom Moulოghney, a new kind of a car nut, exemplifies the new BMW culture. Though he has a Porsche Boxster in his garage and a DeLorean in his past, he has gone electric and isn't going back.

"It's my intention to have at least one electric vehicle from now on; I hope the options are available," says Moloughney, who pays $600 a month in the second year of a lease of one of BMW's electric-powered Mini E test vehicles. "I don't see any way around us having to reduce our dependence on oil."

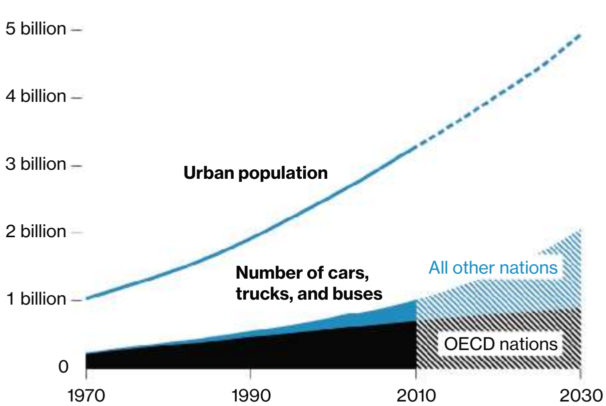
Moloughney installed solar panels on the roof to generate electricity for his daily 60-mile commute between his Italian restaurant in the New Jersey suburbs of New York and his home in rural Chester. Explaining the extent of his commitment, he cites energy independence, cost savings, and environmental concerns.

"What people like about this car is that it has no oil, so it's not hurting the economy, it's not hurting the environment, and it's not supporting countries that are not friendly to the U.S.," says Moloughney, who has a bumper sticker that says "Starve a terrorist! Drive Electric!" on his Mini. His license plate reads EF-OPEC.

There are many contestants, of course, in the race to build an electric car. Later this year, Nissan Motor will introduce the battery-powered Leaf, and General Motors will launch the electric Chevrolet Volt, which extends its range with a gas generator. More of a threat to BMW is Daimler, which has a broader development pipeline. A battery-powered A-Class compact will debut at the Paris Motor Show later this month, adding to fuel-cell buses on the streets of Hamburg, electric-powered Vito vans in Stuttgart, and a test fleet of 1,500 battery-powered Smarts in places such as Berlin, Paris, Rome, and London. The view from Munich is that the rivals are pedestrian.

Tomorrow's Urban Car Buyers

More than 2 billion vehicles will be on the road within the next 20 years, and most of that growth will be in the developing world



DATA: U.N. DEPT. OF ECONOMIC AND SOCIAL AFFAIRS, UNIVERSITY OF LEEDS INSTITUTE FOR TRANSPORT STUDIES

"Since we're BMW, we don't want to create just any old electric car," says design chief van Hooydonk. "We want to deliver what people so far think is impossible: the combination of joy and zero emissions."

Though the Mini is popular and seems to carry some component of joy, the electric version of the car is nothing special technically. The rushed project pushed out in 2008 is a simple conversion, which placed more than 5,000 laptop batteries where the back seat is supposed to be.

BMW also has a checkered past with alternative fuels. The company spent years developing hydrogen-combustion technology, using hard-to-handle liquid hydrogen, which needs to be cooled to minus 253 degrees Celsius, just 20 degrees above absolute zero, to become a fluid. BMW showcased the technology in 2007 by outfitting 100 of its 7-Series sedans with bulky hydrogen tanks; the fuel, however, boiled away despite insulation equivalent to 17 meters (55 feet) of Styrofoam.

Perhaps the most daring part of Reithofer's plan for the Megacity is that he expects to make money with the car, despite the use of costly materials like lightweight aluminum and carbon fiber. The company has set up a $100 million factory near Seattle, together with partner SGL Group, to make the carbon fiber for the car's passenger safety cell. The use of carbon fiber is key to BMW's strategy for the Megacity, which will be big enough for four people and be marketed under a new BMW subbrand. Because the material is 50 percent lighter than steel, the carbon fiber will reduce the size and cost of the battery needed to move the car. Until now the automotive use of carbon fiber has been limited to Formula 1 race cars and other high-performance autos, where price isn't an issue. But BMW insists it can mass-market carbon fiber components, which will be glued together to form the safety cell. In addition, BMW is preparing a new test vehicle—the ActiveE, a converted 1 Series coupe—which will have lithium-ion battery packs developed by BMW and its partners Samsung SDI and Robert Bosch, as well as new electric motors.

BMW is also planning to expand its conventional business, adding more small cars to its namesake brand and expanding the Mini line with at least a roadster and coupe. It is, too, considering a new factory to support demand in Russia, India, and other emerging economies. All told, the company is looking to sell more than 2 million cars annually by 2020, an increase of 55 percent over 2009.

"I would have decided to produce the Megacity Vehicle even if, contrary to our expectations, it doesn't make money in the first generation," says Reithofer, who hasn't been afraid to break with traditions such as adding front-wheel drive models to the BMW brand, exiting Formula 1 auto racing, and linking with rival Mercedes to save purchasing costs. "As a leader, you can either be an entrepreneur or an administrator. I see myself as an entrepreneur."

When Reithofer shuttles between Penzberg and Munich, he surges down the A95, a speed-limit-free stretch of highway that begs for a car like his 12-cylinder 7-Series. But his view these days looks past the surrounding Bavarian countryside and toward the crowded avenues of Shanghai and Mumbai. Those streets demand a different type of car. B

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According to Michael Eisner, Don Zimmer knew the meaning of partnership Page 94



The Gurus Of Greed

How a cadre of trading floor veterans helped Oliver Stone capture the details and nail the nuances in *Wall Street: Money Never Sleeps*. *By Joe Pompeo*

FILM STILL: BARRY WETCHER, COURTESY TWENTIETH CENTURY FOX; ZIMMER: REUTERS/CORBIS

Etc. Wall Street

Standing on the Manhattan set of his latest film, *Wall Street: Money Never Sleeps*, Oliver Stone was surrounded by a fictitious who's who of banking. His actors were sitting at a wooden conference table in a dark-paneled room intended to resemble the Federal Reserve Bank of New York. The scene was an interpretation of the late-night negotiations that took place on Mar. 14, 2008, as Bear Stearns teetered on the brink of collapse. Frank Langella was in character as Louis Zabel, the head of proprietary trading firm Keller Zabel Investments. In plot time, it was about 1:30 a.m. on the worst night of Zabel's life. His firm's stock had plummeted amid rumors of its multibillion-dollar debt; Zabel was trying to persuade the surrounding bank presidents and government officials to bail him out, but there were few takers. Then Stone yelled out, "Where's the china?"

According to Vincent Farrell, a veteran Wall Street investor and one of Stone's consultants on the film, the men assembled that night would have eaten steaks from the Palm restaurant, just like JPMorgan Chase executives had at a similar meeting. Hours after eating, the remains would have been stacked up in the background. However, Farrell noted, the New York Fed doesn't have paper plates or Styrofoam. It uses fine china. That was the problem—there wasn't any. Stone was miffed. "So they went out and bought it," Farrell recalls. "It took a couple hours, but they sent five or six guys out and they came back with boxes of this stuff."

The china didn't end up being visible in the film, but that it could have been underscores Stone's obsession with nailing even the minutest details of the financial industry. For the sequel to his 1987 film *Wall Street*, he recruited dozens of consultants to help. "We went to all levels, anyone who would speak to us," Stone says. "We must have talked to 25 or 35" Wall Street experts. In the spring of 2009, Stone presented an early idea of the movie to short-seller James Chanos, the president of Kynikos Associates. According to Chanos, the version revolved around a short-seller who was bumping off CEOs. Chanos says he pressed Stone to abandon the plot and instead tie the script to the financial collapse of 2008. "*Wall Street* covered the first era of greed and criminality in trading," Chanos says. He told the director: "We just had the financial crime of the century, and you're writing about short-sellers trying to murder CEOs?" Stone doesn't recall this lethal subplot but confirms that the script originally focused on a short-seller. The final product, out Sept. 24, centers on the wreckage of 2008.

"We went to all levels, anyone who would speak to us," says Stone. "We must have talked to 25 or 35" experts

The director also spoke to former New York Governor Eliot Spitzer, who led investigations into investment bank Goldman Sachs and insurer American International Group while Attorney General; Michael Novogratz, a director at Fortress Investment Group; and economist-superstar Nouriel Roubini. Stone even picked the brain of Donald Trump—because, he says, "the way he thinks and talks, the optimism, the implied arrogance—all these things come into play." Stars Shia LaBeouf and Josh Brolin were sent to observe various Manhattan trading firms. Michael Douglas, reprising his role of Gordon Gekko, sat down with Samuel D. Waksal, who served jail time after offering Martha Stewart tips about the stock of his company, ImClone Systems.

Stone, however, was equally concerned with the finer points. The traders in *Money Never Sleeps* are outfitted in Armani and Ralph Lauren suits with Etro ties. They're often shown guzzling caffeinated drinks like 5-Hour Energy as they stare into endless rows of terminal screens. The phrase "You vindictive prick!" was changed in the script to "You vindictive bastard!" after one adviser noted a bank executive's language would be accordingly softened in the presence of high-ranking government officials.

Stone's "attention to detail and getting it right was astonishing," says Farrell, who served as the on-set fact-checker. The 63-year-old had originally been cast for a cameo as a talking head on CNBC—a role he regularly fulfills in real life as the chief investment officer of New York-based Soleil Securities. Stone was so impressed with Farrell's insights that he offered him a job as the film's technical adviser, which Farrell accepted. He offered his services for free, but the director insisted on paying what Farrell describes as a "generous" sum.

"Most of my day was just spent sitting," Farrell says. "They gave me a monitor, and my job was to look at what the camera saw. If I had any comment, I was simply to get it to Oliver. Everything I

The caffeinated trader favorite is one of the many famous cameos in Stone's film



FILM STILLS: BARRY WETCHER, COURTESY TWENTIETH CENTURY FOX

HOW HOLLYWOOD WENT *STREET*

Oliver Stone's consultants added their expertise, one scene at a time

Looking Good, Gekko

Consultants told Stone that, upon disembarking in London, Gekko would get fitted for bespoke suits on Savile Row





The New York Fed Meeting

Stone listened to advice that bank executives would keep their jackets on during the first night of negotiations

Advisers went to great lengths to ensure no papers would be on the table during such a meeting

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mentioned, he did." During filming at the Jersey City (N.J.) offices of Knight Capital Group, Farrell says, the actors were becoming too animated in rehearsals. Farrell made the point to Stone, who subsequently told them to tone it down. "Imagine I'm a trader on the line," Farrell explains. "I might be screaming into the phone, but I'm not gonna be gesturing wildly like you would on the floor." Likewise, during Keller Zabel's meeting at the Fed, Farrell said the actors looked too unkempt. "These guys wouldn't be sitting there with their jackets off. That would come after several days. And they would absolutely not be sitting there with a bunch of papers in front of them," Farrell says. "The Secretary of the Treasury wouldn't have a whole bunch of papers at a meeting like this." Stone took his word for it: The table was cleared and the jackets went back on.

Alex Cohen, a former Securities and Exchange Commission attorney, was present for the 2008 Bear Stearns and Lehman Brothers emergency bailout meetings that inform two scenes in *Money Never Sleeps*. He and fellow former SEC counsel Brian Cartwright worked closely with Stone to make both as accurate as possible. "Did they drink out of paper cups? How many people were sitting at the table?" asks Cohen. As to the larger issues that affected the actors' performances: "How heated did the conversations get? How tense was the environment?"

At one point during the scene, Stone stopped filming and asked Cohen and Cartwright to explain to his actors, in specific detail, the magnitude of the moment they were recreating. "It drove home to me how skilled these actors are," says Cohen. "This was not their world, but when you see them on the screen, you can really feel the emotion of what was going on."

Anthony Scaramucci, managing partner of investment firm SkyBridge Capital and author of the financial advice treatise *Goodbye Gordon Gekko*, received the film's script in July 2009, read it, "took copious notes," and suggested a number of ideas to Stone. In particular, he helped refine the mentor-protégé relationship between Brolin and LaBeouf's characters. "On Wall Street," Scaramucci says, "the older man often tries to crush the younger. This helped Josh create the necessary tension."

Scaramucci also spent hours explaining the



Stone's inside men: Farrell, Scaramucci, and Cohen

TOP: PHOTOGRAPH BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK

"If I had any comment, I was simply to get it to Oliver," says a veteran investor. "Everything I mentioned, he did"

complicated motivation of Bretton James to Brolin. "What I said to Josh was, you're the CEO of [fictitious firm] Churchill Schwartz, let's say it's the Goldman composite. You should be on top of the world, yet you have a feeling of hollowness, because there's a guy out there called Joe Hedge Fund Manager who's making $500 million a year and you're only making $70 million. So what are you gonna do? You're gonna do something dramatically stupid."

Although Stone has no plans for a third *Wall Street* film, Scaramucci and his ilk may not have to return to their day jobs just yet. The film rights to Michael Lewis' latest best-seller, *The Big Short*, have been sold to Brad Pitt. Andrew Ross Sorkin's blockbuster, *Too Big To Fail*, has been optioned by HBO—as has *All the Devils Are Here*, by Joe Nocera and Bethany McLean, which won't even be published until November. Stone's consultants insist his movie's veracity will be hard to top. "There's nothing in this film that's bulls--t," says Farrell. Well, almost. Asks Chanos: "Do you think anybody on Wall Street is as good-looking as Josh Brolin?" B

Terminal Velocity

Even when portraying characters in crisis, Stone's cast was told not to gesticulate wildly

A snapshot of the trader's diet: caffeine and endless numbers





The Big Three

One adviser told Brolin that his character's "hollowness" should come from jealousy over making less than a hedge fund manager

According to Maestripieri, BlackBerry thumbing is like eating peanuts alone at a party

Need a Lift?

The way you behave in the elevator says a lot about you—and it's not all good. *By Tim Murphy*

Every day in New York, people take 30 million elevator rides in 58,000 elevators, according to the trade group National Elevator Industry. It's a weird nonmoment in which strangers share a tiny space. "We silently agree that the other people don't exist," says Tonya Reiman, author of *The Power of Body Language*. According to Dario Maestripieri, a University of Chicago behavioralist and author of the forthcoming *The Biology of Everyday Life*, this instinct is deeply rooted. "Being in a restricted space with strangers is tension-provoking," he says. "So we do unconscious things to minimize the risk of conflict, like not making eye contact. If you put monkeys in a small cage, they avoid each other."

How we behave in those seconds of entrapment says a lot about us. What follows is a survey of elevator-rider behavior based on research conducted in 10 Manhattan office buildings. *Bloomberg Businessweek* categorized the behaviors of more than 100 riders into 10 groups, which appear below along with explanations from a panel of experts: Reiman; Maestripieri; Patti Wood, author of *Success Signals*; and Marilyn Puder-York, author of *The Office Survival Guide*. Think twice the next time you fold your hands in front of your pelvis. We know what you're thinking. B

Fig. 1

Awkward Cell-Thumber

41% *(of riders observed)*

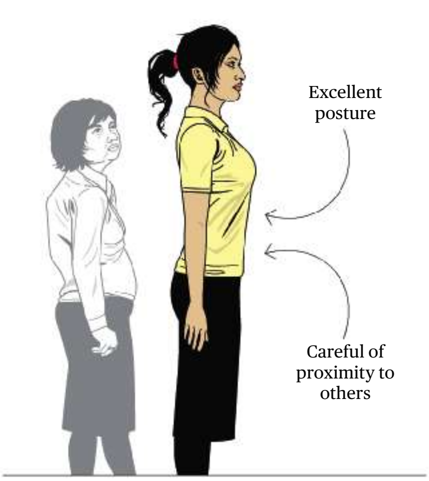


"A lot of those people don't even get a signal in the elevator," says Reiman. "They're giving the impression they're busy, and saying, 'Don't worry about having a conversation.'" According to Maestripieri, this "displacement activity" is a self-distraction in "a tense situation."

Fig. 5

The Yoga Master

6%



With their heads up straight, arms down, and feet planted firmly, some riders are the picture of contentment. "These people are very self-aware," says Reiman. "We can become that way when we're forced into proximity with another person."

Fig. 6

Hands-in-Pockets Guy

5%



A generally male profile, experts say, since more men wear pants with pockets. "You're demonstrating insecurity, even if you're not insecure," says Reiman. According to Wood, "It's a bit scarier, guy to guy, when one guy's hands are in his pockets. Does he have a weapon?"

Fig. 7

The Adam and Eve

5%



A number of men unwittingly ride in the elevator with their hands clasped in front of their crotches, a protective gesture known as the fig-leaf position, signaling vulnerability. "Women in elevators put their paperwork or purse up around their chest," notes Wood.

Other Noticeable, Yet Less Common Elevator Behaviors ▸ SERIAL HUMMERS / **Wood: "It's a way of getting**
"This is a vulnerable, child-like position." ▸ STRETCHERS / **Maestripieri: "Some people have weird manners."** ▸ CONVEX PELVIS

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Fig. 2

The Arm-Crosser

14%



"This mini-hug makes people feel better about the elevator ride. It says, 'I'm not open to conversations,'" says Reiman. It isn't necessarily an aggressive position, though. "A person with arms crossed is saying that they're harmless by creating a softer, smaller silhouette," says Wood.

Fig. 3

The George Costanza

12%



Going through a bag or ruffling up a newspaper is a classic distraction technique that puts up a wall against engagement. "It shows anxiety," says Wood. "It's a form of self-comfort. Also, when we're anxious the nerve endings in our nose begin to twitch."

Fig. 4

The Mumbler

6%



Talking to oneself is, says Reiman, "a kinesthetic move. [Mumblers] start going through their day, 'What did I do? What do I still have to do?'" Mumblers are also shoe-gazers. By avoiding eye contact, according to Wood, they're saying: "'I'm not here to threaten or challenge you."

Fig. 8

The Door-Gunner

4%



This rider signals that he or she needs to be the first out when the doors open. Says Puder-York: "That's a Type-A person. It shows a lack of caring." The guy with his hand on the door the whole time? He's thinking, says Reiman, "'If I hold it, I will get there faster.'"

Fig. 9

Mr. Uptight

4%

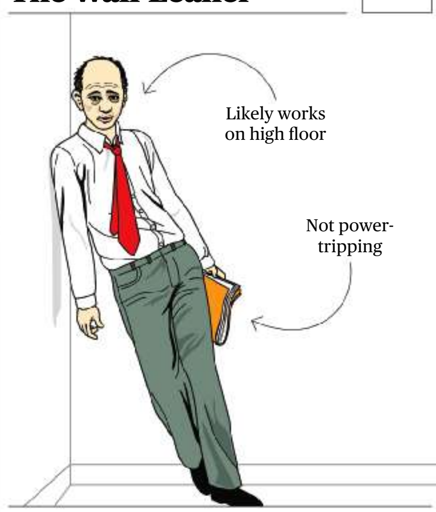


Some people make the trip while standing straight, like choir boys with bladder problems. "They want to keep their distance from you and have the exit as close as possible the minute the door opens," says Reiman. "They're guarding the entry of the cave," says Wood.

Fig. 10

The Wall-Leaner

3%



Wall-leaners often work on higher floors, allowing them extra time to lean. Says Reiman: "They're more relaxed, but they don't want to get involved." According to Wood, the lean is more calculated: "That says either 'I'm tired' or 'I'm not showing any need for power control.'"

ILLUSTRATIONS BY ELLIOT THOBURN

stress out—or signaling you're harmless." ▶ BIG EXHALERS / Reiman: "It's a relaxation tool." ▶ PIGEON-TOED STANDERS / Reiman:

RIDERS / Wood: "Definitely a sexual come-on." ▶ PIVOTERS / Reiman: "They have little concern for the bubble we're sharing."

Etc. Hands On



Sony's Wii Avatar

The PlayStation Move will get even serious gamers off the couch. *By Barrett Sheridan*

The living room workout has come a long way since the days of Jane Fonda in spandex. In 2006 the interactive Nintendo Wii system successfully bridged the gap between hardcore gamers and those looking for a cheap sweat. Four years and 30 million units sold later, other companies are looking to get in on the action.

Sony's entry in the category, the PlayStation Move, isn't technically a new console. The Move, released on Sept. 17, can be purchased as a set of hardware add-ons for the existing PS3 system. The $100 starter pack includes a controller, a mounted camera, and a copy of the Sports Champions Blu-ray game package, which includes six games, from bocce to beach volleyball. Those without a PS3 can pay $400 for the console plus the Move accoutrements.

The Wii's success was founded partly on Nintendo's ability to position it as a device for everyone. The Move, however, is designed to convince couch-bound players of the power of upright gaming. The system's seriousness is encoded in its electronic DNA: The remote's innards contain an accelerometer, a gyroscope, and even a high-tech compass. It's also topped by a glowing plastic sphere that helps the PlayStation Eye Camera, which sits on or below your TV, track your movements. (The Eye connects to the PS3 console via a USB cable.)

The result is a highly accurate remote that can register a wide array of motions. In the volleyball game, there are discrete motions to set, spike, dive, serve, and even block an opponent. However, the greater accuracy makes it far less forgiving than the Wii. The Eye may interpret a table tennis backhand a little too authentically for some.

As a functioning video camera, the Eye blends the real and virtual worlds in ways the Wii can't. The game that best explores this capability—known as augmented reality—is called EyePet, which uses the camera to display your living room on the TV screen. Players sit on the floor, where their onscreen images hatch, feed, and play with a virtual pet. (Don't worry, the game is intended for kids.)

The Move goes further than any other system to date in bridging the physical and virtual worlds. Though perhaps not for long: Microsoft's Kinect system, timed for release during the pre-Christmas stampede, does away with controllers altogether and simply interprets hand and body movements. Regardless of which poses the largest threat to Wii, the days when the thumb was the most important part of a gamer's body are all but over. B



PlayStation Move

The $100 starter pack includes a controller, the PlayStation Eye Camera, and the Sports Champions Blu-ray package

TOP: PHOTOGRAPH BY JAMIE CHUNG FOR BLOOMBERG BUSINESSWEEK

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Etc. Wealth

The Other Oracle of Omaha Speaks



Invest in coin counters

Wally Weitz scouts for broken growth stocks, arbitrage plays, and underappreciated small caps

The recovery is weak and uneven and will probably continue to confuse investors. We're wary and trying not to be arrogant about our predictions. However, enough sectors are moving forward that we can see growth in various companies we're investing in. Our Weitz Partners III Opportunity Fund is our most flexible mutual fund in terms of tactics we can use. We can look at companies of all sizes, sell stocks short, and use a limited amount of leverage.

To protect ourselves, we sometimes employ a "defensive short." This means finding a group of stocks, or a sector, that seems fully valued or overpriced and shorting it to buy more of our favorite stocks on the long side. In the last several years we've been shorting smaller-company stock indexes such as the Russell 2000. I'm not negative on small caps, but they've generally been more popular and a little more expensive than much larger companies. These shorts, which typically account for 10% to 20% of our portfolio, allowed us to make a bigger bet on our top five or ten best ideas, which has worked out well.

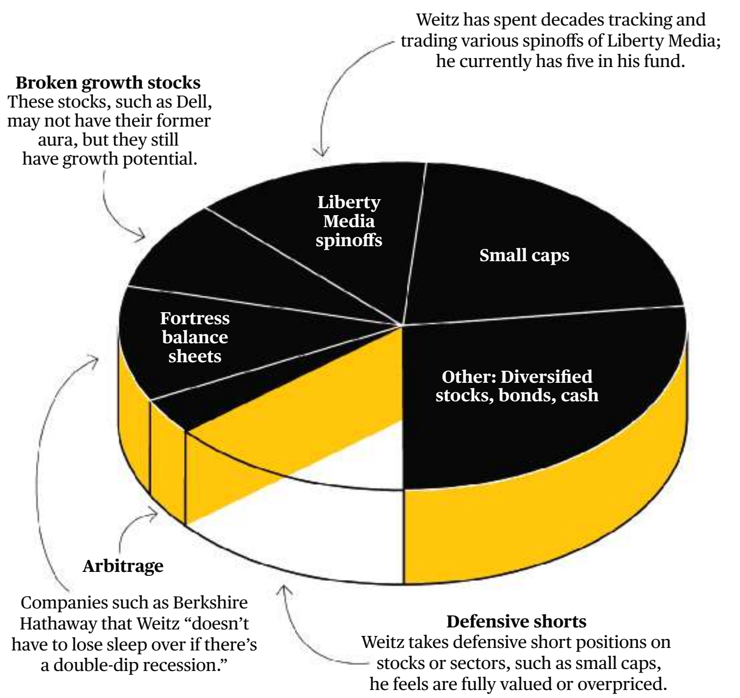
Lately we've been investing in broken growth stocks. For instance, Microsoft is benefiting from a positive product cycle and has a fortress balance sheet. It also has a reputation for having wasted tens of billions of dollars in R&D and new product ideas that haven't really worked. I don't pretend that Microsoft is going to be a dynamic growth stock like it was 20 years ago, but at 25 a share it seems very likely the stock will find its way back to the 30s. Dell has also made missteps and been eclipsed by Hewlett-Packard in certain ways. Yet at 12 a share, it's being totally disrespected. It doesn't deserve the aura it had 10 years ago, but it's fairly easy to make a case for the stock going from 12 to 18–a 50 percent gain.

In this environment, large, high-quality–but underappreciated–companies seem to be the cheapest and the most comfortable to own. However, we have major exposure to a handful of smaller companies that have gotten no respect over the last three or four years, such as Liberty Media Interactive, which owns QVC shopping network. Another is Coinstar, which is rooted in a business that puts coin-counting machines in supermarkets. A few years ago, the company branched out into the DVD rental business, which has been very successful.

One of our most recent purchases is SandRidge Energy. People saw it primarily as a natural gas company. It was underappreciated because of the low price of gas and a leveraged balance sheet. People ignored the fact that it had a pending acquisition of Arena Resources [completed in July]. Arena is primarily an oil company and its assets made a major difference to the quality of SandRidge's balance sheet. SandRidge seemed mispriced because it was underappreciated for reasons that would only be temporary. Ⓑ —*As told to Lewis Braham*

A FUND WITH FLEXIBILITY

The Weitz Partners III Opportunity Fund can go short, use leverage, and buy any size company it likes



DATA: WEITZ FUNDS, AS OF JUNE 30

At 12 a share, Dell is being totally disrespected. It could rise to 18– a 50 percent gain

The Stats: Wally Weitz is sometimes called "the other oracle of Omaha." His Omaha-based firm, Wallace R. Weitz & Co., manages about $3 billion for the Weitz Funds. One of his oldest funds, Weitz Partners III Opportunity, was a hedge fund that converted into a mutual fund in 2005. Since its 1983 inception, it has had a 12.8% annualized return, vs. 9.8% for the S&P 500.

OCEAN/CORBIS

Etc. Navigator

Where the Spirits Move You

Forget Napa. On your next business trip, make time for these bibulous detours. *By Kurt Soller*



A half case of 2004 Chapel Down Pinot Reserve costs about $200

British Bubbly
Starting Point: London

THE PLAN: With its crisp acidity, English sparkling wine is emerging as a viable option to Champagne and prosecco. Drive an hour southeast to posh Kent for the best wineries: **Chapel Down** (Tenterden Vineyard, Small Hythe Road, Tenterden), **Lamberhurst** (Lamberhurst Down, Lamberhurst), and **Biddenden** (Gribble Bridge Lane, Biddenden), have all produced award-winning sparkling varietals. **STAY:** Biddenden rents a handsome loft that sleeps two, comes with a kitchen, and has vineyard views (Gribble Bridge Lane; $210 to $350/2 nights). **EAT:** Devour classic pub fare plus 11 kinds of pudding (that's English for dessert, you philistines) at the **White Lion**, 10 minutes away on High Street in Tenterden.

The Northern Illinois Red Trail
Starting Point: Chicago

THE PLAN: Head northwest to the 15 vineyards on the Northern Illinois Wine Trail. Tastings ($10 or less) improve with distance: Three hours away, **Massbach Ridge Winery** (8837 S. Massbach Rd., Elizabeth) and **Galena Cellars Vineyard** (515 S. Main St., Galena) have the best reds of the region. **STAY:** The **Felt Manor Guest House** (below) in Galena has five rooms in an 1850s mansion (125 S. Prospect St.; from $125/night). **EAT:** Before leaving Chicago, hit venerable **Charlie Trotter's** (816 W. Armitage) for its massive wine list. An $85 bottle of cabernet from Roselle, Ill., shows what the state can do.





The New England Brewery Crawl
Starting Point: Boston

THE PLAN: Start at **Harpoon Brewery** (306 Northern Ave.), where you'll learn to make a bitter India Pale Ale. Don't sample too many—you're driving an hour to Portsmouth, N.H., and the **Redhook Ale Brewery** (35 Corporate Dr.). Continue another hour to Portland, Me., for dark ales at **Allagash Brewing Company** (50 Industrial Way) and **Shipyard Brewery** (86 Newbury St.). **STAY:** The stunning **Chebeague Island Inn** is a 25-minute ferry ride from Portland (61 South Rd.; from $160/night). **EAT:** At **The Farmer's Table** (205 Commercial St.), go for local seafood options, like the Casco Bay mussels ($9.95).





After touring Harpoon Brewery, take home a 64-oz. growler

CORKSCREW: PETER DAZELEY/GETTY IMAGES; MUSSELS: MARKA/ALAMY; ROOSEVELT: CORBIS; CAVIAR: JONATHAN KANTOR STUDIO/GETTY IMAGES

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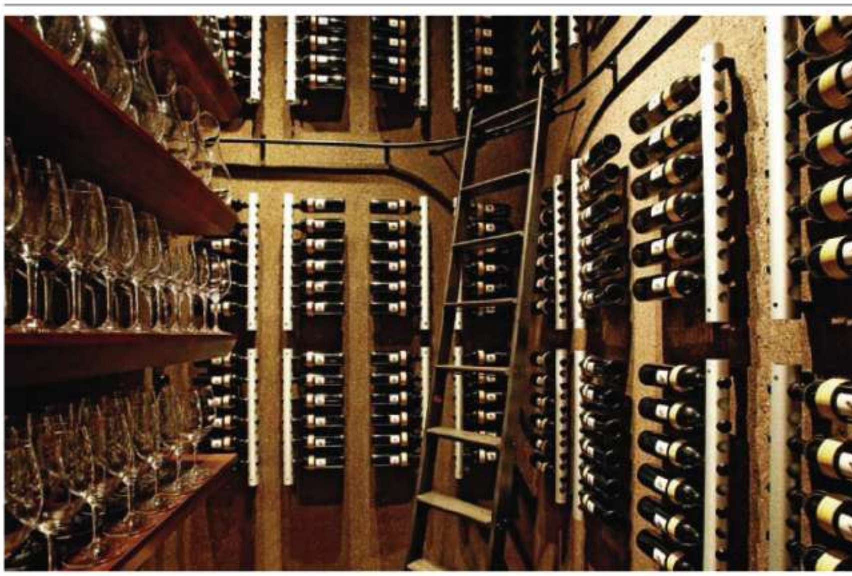
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The Kentucky Bourbon Trail
Starting Point: Cincinnati

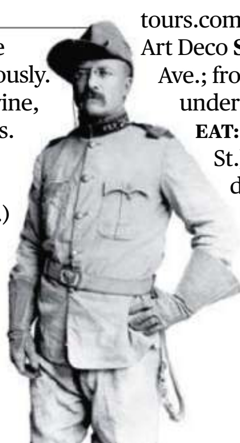
THE PLAN: Kentucky's Bourbon Trail, a 70-mile route two hours south of Ohio, features six distilleries including **Wild Turkey** (1525 Tyrone Rd., Lawrenceburg) and **Maker's Mark** (3350 Burks Spring Rd., Loretto). Map your route on kybourbontrail.com (all tours are $5 or less). **STAY:** Anchor a two-day trip at the **Old Bardstown Inn** (510 E. Stephen Foster Ave., Bardstown; about $60/night). **EAT:** At **Chapeze House** (107 E. Stephen Foster Ave.), local couple The Colonel and Margaret Sue serve bourbon-marinated meat and lead their own tasting (dinner, about $30). Afterwards, top yourself off at **The Old Talbott Tavern** (107 W. Stephen Foster Ave.).



The Old Talbott Tavern has been a bourbon-drinkers institution since the 18th century



Texas Vineyard Hopping
Starting Point: Dallas



THE PLAN: Texas vineyards are winning national awards–seriously. Some of the best are in Grapevine, an hour from downtown Dallas. Don't miss **Delaney** (2000 Champagne Blvd.), and **La Buena Vida** (416 E. College St.) vineyards for tastings of chardonnay, voignier, or pinot blanc. For the wobbly-legged, **Grapevine Tours** shuttles you to three wineries and takes care of lunch ($54.50, grapevinewinetours.com). **STAY:** Return to Dallas for the Art Deco **Stoneleigh Hotel** (2927 Maple Ave.; from $179/night), which recently underwent a $36 million renovation. **EAT:** At **Local** (above, 2936 Elm St.), a bistro in the Deep Ellum district, the inventive tasting menu is $70. On the way back to the hotel, grab a nightcap at **Teddy's Room** (2024 Cedar Springs Rd.), named after T.R. himself.

The Russian Vodka Tour
Starting Point: Moscow



THE PLAN: Take the metro to the **Vodka Museum** (ul. Izmailovskoye Shosse, 73G) and taste samples with caviar. After the primer, head to **Moscow Distillery Cristall** (ul. Samokatnaya, 4), where you'll drink 15 blends of unpronounceable delights. **STAY:** The 92-room **Golden Apple** (ul. M. Dmitrovka, 11), with Philippe Starck fixtures and a global menu, is a Muscovite steal at $400 per night. **EAT:** For authenticity, try newly opened **Hachapuri** (Bolshoi Gnezdnikovsky Pereulok, 10) for Georgian cheese-filled bread, spiced vegetables, and, of course, "bread wine." For Russian glitz and model watching, book a table at **Galereya** (below, ul. Petrovka, 27). B



As CEO of Disney, Eisner had nicknames for his various collaborators



Putting the "Me" Back in Team

What makes a partnership great? When one person strokes the ego of another. *By Ian McGugan*

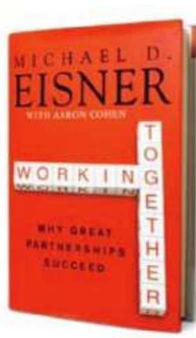
The first clue that Michael Eisner is irony-deaf appears on the cover of his new book. Above the pious title—*Working Together: Why Great Partnerships Succeed*—Eisner's name appears in huge letters, leaving scant room for that of his collaborator, Aaron Cohen, in tiny type below. Here's a tip, guys: If you're going to write a book extolling the benefits of partnership, get the optics right. An innocent reader might jump to the conclusion that Eisner's ego is so large it overwhelms everything around it.

A well-informed reader might agree. There was, for instance, that $250 million breach-of-contract lawsuit with former protégé Jeffrey Katzenberg, who accused Eisner of bilking him in 1994. Then there was the infatuation with superagent Michael Ovitz, whom Eisner dumped a mere 14 months after hiring him. There was also the dispute with Steve Jobs over Walt Disney's distribution deal with Pixar. According to James B. Stewart's definitive account of the Eisner era, *Disney War*, the author of *Working Together* referred to those former collaborators, respectively, as "the little midget," a "psychopath," and a "Shiite Muslim." A feud with Roy Disney ultimately resulted in Eisner's departure from the company in 2005.

i

Working Together: Why Great Partnerships Succeed

by Michael D. Eisner with Aaron Cohen
(HARPERBUSINESS, 304 pp, $25.99)



What's a bloodbath, or four, to a Hollywood mogul? For all his bleak history with partners, Eisner was indisputably half of the duo that reinvigorated Disney in the late 1980s. According to Eisner, the decade he spent working alongside Frank Wells—who died in a 1994 helicopter accident—was a wonderful partnership. Inspired by that experience, Eisner interviewed members of other successful working relationships to find out exactly what makes them click, clearly gunning for heartwarming tales of people working side by side, sharing risks and building empires. Yet what he discovers is the messy reality of alpha males and their butting egos, which he attempts to gloss over with all the Mickey Mouse enthusiasm he can muster. As with many of the box-office stinkers Eisner green-lighted after Wells died (*Treasure Planet* is surely selling in a 99¢ DVD bin near you), this look into partnership badly needed an editor. While Eisner seems genuinely interested in talking up the benefits of working together, he appears blissfully clueless of the ways in which his own anecdotes undermine his thesis.

Consider Eisner's account of a key meeting in 1984, when he was the president of Paramount Pic-

FROM LEFT: RON GALELLA/WIREIMAGE; LEE CELANO/REUTERS; ROSE PROUSER/REUTERS

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tures. The entertainment lawyer Stanley Gold proposed a deal in which Eisner and Wells, the former president of Warner Bros., would become co-chief executive officers of Disney. Eisner rejected the offer on the spot, demanding that he alone be named CEO over the older and more experienced Wells.

For reasons known only to him, Wells acquiesced and became Eisner's second-in-command. While some might see this as an example of running from the elephant ego in the room, to Eisner it's the beauty of teamwork. When it comes to complimenting his partner of a decade, Eisner's praise is, shall we say, nuanced. He recounts how, on their first day together at Disney, Wells was under the naive impression they might share the office where Walt himself once worked. Having none of that, Eisner made his desire for privacy perfectly clear, and his No. 2 obediently jumped up and took the office next door.

It's at this point–about 10 pages in–that it becomes clear what Eisner extols as partnership is actually something quite different. The book applauds Wells' ability to support any idea Eisner threw out and cites a sycophantic, five-page, handwritten note Wells gave the author in 1989 as an example of their compatibility. Writing to both Eisner and his wife, Wells–also speaking on behalf of his own wife–explained his need to "acknowledge ... our feelings about you both and what you've done for Disney and, derivatively, for our family." What prompts an executive to write his "partner" such a letter after five years of working together every day? It's a question that Eisner never answers, but it may explain how Wells held on to his job for so long.

Of the 10 partnerships Eisner examines, two feature partners who have been dead for more than a decade (Wells and Ian Schrager's former Studio 54 running mate, Steve Rubell). Two more partnerships are defunct because people have retired. One partnership, that of Bill and Melinda Gates, is actually a marriage. Of the five partnerships that qualify as living, breathing business relationships, at least two aren't partnerships in the traditional sense. Warren Buffett and Berkshire Hathaway Vice-Chairman Charlie Munger have swapped thoughts for decades on potential investments, though they don't live in the same city, much less share an office. Same goes for producer Brian Grazer and director Ron Howard. These examples suggest successful partnerships are as much about distance as they are about intimacy, a theme Eisner is perhaps saving for the sequel.

The clearest lesson of this book is that the most successful business relationships rely on one partner deliberately subjugating himself or herself, as Munger did with Buffett, as New York Yankees bench coach Don Zimmer did with manager Joe Torre, and, of course, as Wells did with Eisner. The author hints at this sober conclusion but prefers to dwell on sweeter observations that would fit into any Disney log line. Partners, he asserts, must trust one another, keep their egos in check, and share a sense of morality. Eisner slips into the realm of the absurd when he proposes that more successful partnerships might be an antidote to the virus of executive greed that led, he boldly asserts, to the recent financial crisis.

For anyone who remembers the hundreds of millions in stock options that Eisner garnered during his tenure at Disney, when he was one of the highest-paid executives in the world, this insight is the most hilarious punch line of all. Particularly, it so happens, as Eisner is said to be a candidate to take over the Tribune Co. If Wells were alive, let's hope he'd lean forward and suggest gently to Eisner that he's making a fool of himself. Though all evidence indicates that their beautiful partnership would never have survived if Wells did anything of the kind. **B**

Frank Wells, Eisner's former partner, once wrote him a five-page, praise-filled letter. Now, that's teamwork

Divine Secrets of the Ya-Ya Brotherhood

The key to partnership often relies on one person deferring to another. Here are some Eisnerian examples of great collaborations.

1
Joe Torre and **Don Zimmer** (*manager and coach, New York Yankees*): This partnership may have thrived in opposition to a common opponent, owner George Steinbrenner–until The Boss upended it. Zimmer left after the 2003 season, Torre followed in 2007.

2
Valentino Garavani and **Giancarlo Giammetti** (*fashion designer and the brand's business manager*): Valentino designed dresses and demanded attention; Giammetti handled everything else: "My strength ... was to work in the back," he says.

3
Warren Buffett and **Charlie Munger** (*investors, Berkshire Hathaway*): Usually a dominant personality, Munger is willing to submerge his ego and let Buffett take center stage. "I want the spotlight, but he doesn't," says Buffett.

4
Steve Rubell and **Ian Schrager** (*proprietors, Studio 54*): The charismatic Rubell manned the door of the famed nightclub while Schrager (aka "the Ghost") sat in the back room counting the cash and running the business.



FROM LEFT: JIM SPELLMAN/GETTY IMAGES; DAVE M. BENETT/GETTY IMAGES; CHRIS MACHIAN/ BLOOMBERG VIA GETTY IMAGES; TIM BOXER/HULTON ARCHIVE/GETTY IMAGES

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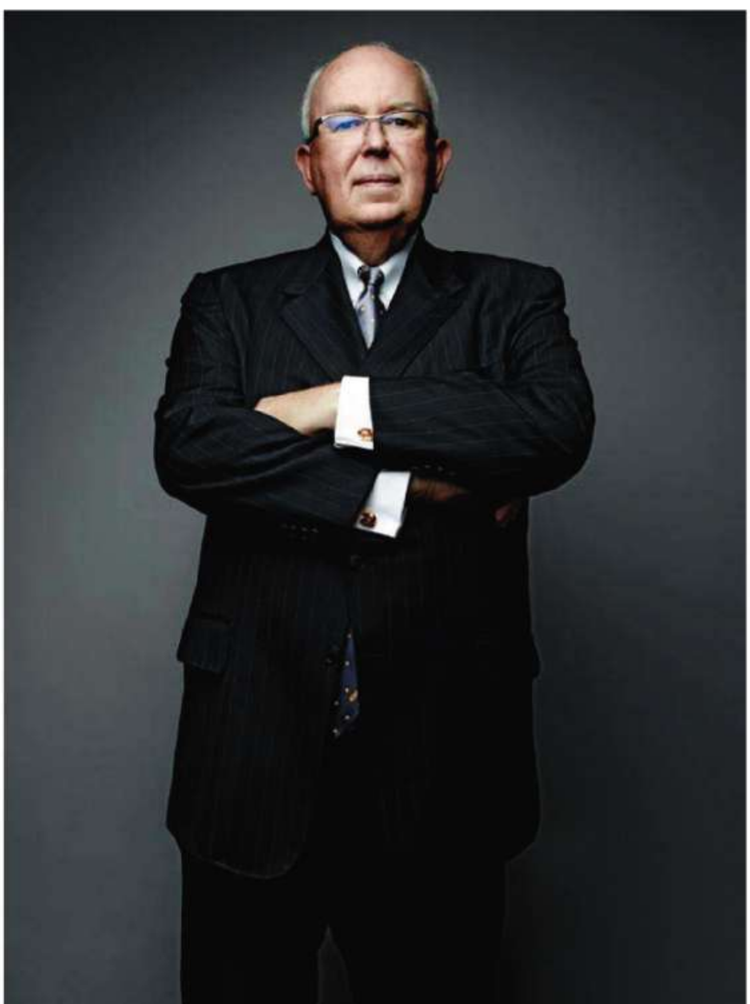
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Etc. Hard Choices

John Rowe

"Mayor Daley was gnawing my liver out. ... After my first year, he let me know time was running out. Honeymoons don't last long in Chicago"

The chairman and CEO of Exelon on cutting costs, giving up coal, and staking his company's future on nuclear energy



In 1998 I became chairman of Commonwealth Edison. It was a big, troubled Chicago utility with a history of high rates, a clunky fossil fleet, and poorly performing nuclear plants. And I came in as the Illinois legislature decided to bring competition to the electricity business.

Something had to give. We contemplated breaking up the company, but we would have gotten very little for those nuclear plants. Given how they were running, they were virtually worthless. We had invested $10 billion and weren't getting a return. When you have nuclear plants, they own you. They're a massive responsibility; they make or break your reputation.

We needed cash. We couldn't rebuild the nuclear fleet and upgrade the coal plants, too, so I decided to give up coal. In the middle of all this, we were having terrible reliability problems. Mayor Daley was gnawing my liver out because of service, and he was right. After my first year, he let me know time was running out. Honeymoons don't last long in Chicago.

My choices were constrained by the fact that we'd invested so much in our nuclear plants. We had to make a bet that nuclear would work and, in the long run, be worth more than coal. There was also a lot of nervousness around nuclear energy. Three Mile Island, which didn't hurt anyone, ruined the industry for more than a decade and destroyed growth for several decades.

I orchestrated a merger with PECO (Philadelphia Electric Co.) to create Exelon. Life isn't just about what you want to be. It's about what you are. We had become a culture of trying rather than a culture of succeeding. A lot of good people had to go. We needed some way to grow. Real growth requires a totally new technology or consolidation. We've since become one of the fastest-growing players in the industry.

This is a massively unforgiving business. It's not China or Japan that you worry about. It's that unidentifiable country that builds one plant but doesn't have the regulatory or engineering infrastructure to handle it. If something goes wrong, it affects all of us. *—As told to Diane Brady*

PHOTOGRAPH BY MIKE MCGREGOR FOR BLOOMBERG BUSINESSWEEK

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